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CIS

UNITED STATES-JAPAN TRADE RELATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

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UNITED STATES-JAPAN TRADE RELATIONS

THURSDAY, MARCH 10, 1983

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:10 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

[The press releases announcing the hearings follow:]

[Press release No. 4, Tuesday, Feb. 15, 1983]

Hon. Sam M. Gibbons (D. Fla.), Chairman, Subcommittee on Trade, Committee on Ways and Means, U.S. House of Representatives, Announces Hearings on United States-Japan Trade Relations

The Honorable Sam M. Gibbons (D. Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will hold public hearings on United States-Japan bilateral trade relations. The hearings will take place during the month of March. No specific date has yet been scheduled.

The hearings will be held prior to the departure on March 24, 1983, of a Trade Mission to the Far East headed by Chairman Gibbons and including Members of the Committee on Ways and Means. Japan will be among the countries visited during the Mission.

Topics to be discussed during the Subcommittee hearings will cover a broad spectrum of United States-Japan bilateral trade issues. Among the possible topics of discussion are:

(1) The current degree of openness of the Japanese market to competitive U.S. products, including a review of progress by Japan in implementing its three previously announced trade liberalization packages.

(2) The status of the United States-Japan Government procurement agreement regarding purchases by Nippon Telegraph and Telephone (NTT) of U.S. products.

(3) Competitive conditions existing for trade in high technology products between the United States and Japan.

(4) Japan's industrial policy, including targeting of competitive industries and adjustment policies toward declining industries, and its implications for international trade flows.

(5) The current relationship of the Japanese yen and the U.S. dollar.

Requests to be heard may be made by telephone to Harriett Lawler [telephone (202) 225-3627]. The request should be followed by a formal written request addressed to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. In addition to dates, times, and location of the hearings, details of statement requirements will also be announced in a later press release.

[Press release No. 5, Friday, Feb. 25, 1983]

HON. SAM M. GIBBONS (D. FLA.), CHAIRMAN, SUBCOMMITTEE ON TRADE, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING ON UNITED STATES-JAPAN TRADE RELATIONS

The Honorable Sam M. Gibbons (D. Fla.), Chairman of the Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Subcommittee will hold a public hearing on United States-Japan bilateral trade relations. The hearing will take place on Thursday, March 10, 1983, beginning at 9:30 a.m. in room 1100 Longworth House Office Building. Plans for the hearing had been announced previously in Subcommittee press release No. 4.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Requests to be heard must be made by telephone to Harriett Lawler [telephone (202) 225-3627] by noon, Tuesday, March 8, 1983. The request should be followed by a formal written request addressed to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 75 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearances.

Each statement to be presented to the Subcommittee or any written statement submitted for the record must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where he or his designated representative may be reached);
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of the comments and recommendations in the full statements.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit at least six (6) copies of their statement, by the close of business, Friday, March 18, 1983, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may submit 50 additional copies for this purpose if provided to the Committee during the course of the public hearing.

Chairman GIBBONS. Good morning, ladies and gentlemen.

This is a meeting of the Trade Subcommittee of the Ways and Means Committee. We had planned to start at 9, but most of our Members are used to the 9:30 convening time. We are going to try to, this morning at least, break the habit and get started a little earlier.

I have so many things I would like to say that perhaps I will not say them all at the beginning. Let me say that fundamentally our objective in holding these hearings is to gain a greater understanding of the differences that are very evident between the United States and Japan and the problems that we have, not only the real differences but the perceived differences in the eyes of both sides.

The purpose of this hearing will be to try to understand these better. If understanding will ameliorate some of our problems, that objective will have been accomplished.

Our objective as far as trade is concerned is not to seek a bilateral balance of trade with the Japanese but to seek bilateral reciprocal access to the Japanese market. All we ask of the Japanese—at least all I ask of the Japanese—is they give us the same opportunity to sell our products in their country that we give them to sell in our country.

And there appears in my mind to be a difference in this. We want to define that difference, if it is there, and we want to see what needs to be done and perhaps what has to be done in the form of law to correct this problem. I hope that all of us will enter this hearing today with that in mind and that we will work constructively to try to solve this problem. That would be what I would like to do.

I have a more formal opening statement that I will place in the record.

[The statement follows:]

OPENING STATEMENT OF HON. SAM M. GIBBONS

Good morning ladies and gentlemen. As you know, this is a meeting of the Subcommittee on Trade of the Committee on Ways and Means. Our topic of discussion for today is an overview of one of the most important trading relationships of the United States—our relationship with Japan.

United States-Japan trade relations are extremely important, but at the same time increasingly controversial. In 1982, two-way merchandise trade between our two countries totalled more than $57 billion. U.S. exporters sold more than $20 billion worth of goods to Japan last year, while the United States took over $37 billion in imports from Japan.

The controversy in our relationship, as well as the significance, stems from those trade figures—specifically, the large trade deficits that the United States has been experiencing with Japan. Those deficits are particularly controversial in light of continued problems that U.S. exporters face in gaining access to the Japanese market. Certainly there is a general perception in the United States that our market is much more open to Japanese products than the Japanese market is to U.S. products.

The purpose of our hearing today is to cover a broad spectrum of United States-Japan bilateral trade issues. We will focus on current degree of openness of the Japanese market for competitive U.S. products, looking at a variety of factors that might effect our ability to compete with the Japanese. Examples are Japanese industrial policy, the current exchange rate relationship of the yen and the dollar, and other tariff and non-tariff barriers to specific U.S. exports.

The hearing today is being held in anticipation of a trade mission that I will lead to Japan at the end of this month. We plan extensive discussions with Japanese political and business leaders at the highest levels, as well as U.S. businessmen in Japan. I believe that our witnesses today will help us to prepare for those discussions in Japan. Certainly our continued attention to United States-Japan trade matters is crucial.

Chairman GIBBONS. I see Congressman Stark here and Mr. Bergsten. I wonder if we could start with Mr. Stark since we had scheduled him to come first. I know he has prepared himself for this.

Mr. Stark, would you please come forward and take over. We will be glad to hear from you.

STATEMENT OF HON. FORTNEY H. (PETE) STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. STARK. Thank you very much, Mr. Chairman.

Chairman GIBBONS. Let me ask you before you start, please, Mr. Stark, do any of my colleagues here at the table have any statements they would like to make as we open?

[No response.]

Chairman GIBBONS. All right, fine. Go ahead, please, Pete.

Mr. STARK. Mr. Chairman, members of the subcommittee, I appreciate this opportunity to testify. I will be brief.

I would like to suggest a new approach to ameliorating United States-Japan trade frictions. It is an idea which was suggested by Prof. Lester Thurow. He has proposed abolishing all of the current trade restrictions on specific Japanese exports and replacing them with a system of general reciprocity. Under this system, Japan would be allowed a surplus in her trade with us—which all international economists note would be normal under conditions of free and open trade—but this surplus would be limited to a certain amount more than she imported from us. The more she imports from us, the more she can export. As Professor Thurow writes:

> Such a system would preserve the advantages of free trade yet still be able to limit the overall deficit to manageable proportions. No one would be telling the Japanese how to run their economy. We would essentially be offering them an open door. Come into our markets. Export whatever you like. But remember, whatever you export, you have to import a comparable, even if lesser, amount.

I am introducing a bill, which would sunset after 10 years, which would generally accomplish this goal, without getting into specific trade controls on a quarterly basis as Professor Thurow suggested. My bill would allow the Japanese up to $10 billion a year in trade surpluses, but in light of their many trade barriers, both cultural and specific, deficits above that level should not be accepted.

I think Thurow is mincing words when he calls this free trade. It is managed trade. And that gives me pause, and I am not particularly comfortable with this idea—but it is better than the nonsystem we have now which is not managed and which is destroying American and world support for any decent level of trade and which is threatening to spill over into political and military frictions with a treasured ally.

Mr. Chairman, I make this proposal because we must change the present cycle of spiraling trade tensions. This bill seeks to manage United States-Japan trade relations, so as to save our political friendship.

Under the present conditions, our trade disputes are becoming increasingly shrill. As important as the economic relations are, the political relationship of the two democracies is more important, and is a keystone to stability and progress in the Pacific and the world.

Our economic disputes are like monkeys in a cage, we keep picking at each other, and the scratches become ever-more inflamed and infected, spreading and infecting the whole relationship.

I know that relations are deteriorating when a columnist as thoughtful as Robert Samuelson writes a column entitled, "A Bad Trip:"

> Even Westerners favorably disposed toward Japan (as I am) often find themselves angry and alienated by the Japanese. Japan's efforts to defuse economic and political conflicts remain remarkably awkward. At worst, this produces outright racism in the West; at best, enormous frustration.
>
> What is being ruined is one of the world's most important political relationships and, at the same time, a realistic appraisal by Americans of their own economic weaknesses.
>
> . . . as one U.S. official recently said: Japan is the only country he knows from which congressional delegations return more hostile than when they left.

An equally thoughtful columnist, Joseph Kraft, has recently written an essay for the Japan Automobile Manufacturers Association magazine in which he notes:

> Economic tensions, in striking contrast (to political tensions) have grown increasingly querulous. Not only is conflict the rule, but it is increasingly concentrated around small points as distinct from large differences of general outlook. . . .
>
> The same bias away from the major and towards the minor, away from the jugular and towards the capillaries, marks the whole history of the postwar economic dialogue.
>
> Embitterment is the inevitable consequence of these constant shootouts over increasingly low-level issues. . . .

Since it is clearer that many of the barriers are cultural, we face new problems. As a Japanese Embassy officer has said, "asking us to change our culture is like asking us not to speak Japanese." As we increasingly turn toward these cultural barriers, we will come closer and closer to the heart of Japan—and that can only breed enormous resentment.

In recent years, we have made successive demands upon each other. These demands have had little "bottom-line" effect, but they caused us increasingly to make requests upon Japan—which in Japan are perceived as demands—that sovereign nations do not normally make upon other sovereign nations. I suspect that on your next visit to Japan, you will make requests upon Japan which if foreign parliamentarians made on us here in the Longworth Building, would cause us to get up and leave the room. The central theme of the Wisemen's report was that times have changed and that Japan is an economic coequal. Yet the trade disputes we have with Japan cause us to act in an unequal way.

For example, we have objected to internal Japanese excise taxes: but what would we think, for example, if Japan commented on our alcohol excise taxes; we have complained about Japan's internal distribution system and zoning laws that encourage the preservation of mom and pop retail outlets; we object to safety standards that meet Japanese desires (such as kimono guards on auto bumpers); and we have requested that bids being let by the quasi-state corporation, NTT, be translated by the Japanese into English. Can you imagine a Japanese request to the FCC or AT&T that documents be translated into Japanese.

The list goes on, and to what good? The trend line in our deficits continues upward, and domestic anger at Japan soars at the same rate that domestic support for international trade plunges. As Deputy Trade Ambassador MacDonald has been quoted:

> The constituency for free trade in the United States has almost totally eroded. Whether it realizes it or not, the Government of Japan is in a race against time.

The bill I am proposing would provide time. It is a cooling off period.

In another sense, and we should admit this, it is a national 201 case, in which the U.S. economy and society gets time to modernize and rebuild—just as Japan did between 1945 and the 1960's when its trade liberalizations started. To the extent this is a national 201 case, we need to recognize that relief is temporary, and that this is a period in which to prepare to respond better to the admittedly brilliant job which Japan has done.

In exchange for this trade management, the United States and Japan would give up the various special understandings, cartels, VRA's, and OMA's that are formally or informally in effect. The whole cat's cradle of restraints would be removed, and in that sense, it would be free trade.

I believe that this could place a heavy competitive burden on the higher technology industries. Traditionally, Japan has traded up, moving into the clean industries and away from the smokestack industries. Thus, this proposal could cause an intensification of trade competition in the key industries of the future: communications, semiconductors, and information flow. I think that is OK, if we recognize what is likely to happen and spend more of our time and energy working on an industrial policy for these industries which insures their growth. Head-to-head competition in the important industries of the future will surely speed the development of many products for the betterment of mankind.

You might ask, what will be different in 10 years? We have made major changes in investment and savings incentives, and over a decade, these changes may result in a more modern industrial plant. There is a new philosophy of business management in the air, and over a decade, it may make a difference. The pressure will still be on for American industry and labor to become more productive: the pressure from the New Japans of Korea, Taiwan, Hong Kong, and Singapore, as well as the $10 billion in trade competition from Japan, will keep America competitive and responsive to international competition. Japanese investment in the United States should accelerate to maintain markets here, thus in effect matching Japan's demands upon United States firms over the past 30 years.

The 10 years will allow Japan—to speak bluntly—to grow up and become a member of the world community. In the interim, Japan's declining middle-age industries, which are slowly withering despite cartel protection, will give way to more efficient producers—such as the Koreans in carbon steel and the United States and others in wood products, aluminum, and many chemical feedstocks. In 10 years, Japan's consumers should demand more value for their hard labor, and foods (such as beef, citrus, and cigarettes) should be more rationally traded. The yen will evolve into more of a world financial currency and the extreme undervaluations of the yen which have plagued us in recent years should become less frequent.

The question might arise whether we should apply this trade management to other nations where we run a big deficit, or how would we feel if the European Community, where we traditionally have run large surpluses, applied the same standard to us.

My answer is that no other nation is like Japan. It is sui generis. Your own subcommittee trip reports to Japan contain data about how other Asian nations have a nearly impossible time selling to Japan. Very competitively priced quality items are shipped all the way across the Pacific to us, but somehow cannot make it the few nautical miles from Hong Kong, Korea, or Taiwan to the Islands of Japan. If the whole world is having this problem, then the problem needs a unique and special solution. I recommend this bill to manage the system, rather than see the system collapse.

Other Nations, of course, do not have more than $10 billion surpluses with us, or ship us 50 percent more manufactured articles than we ship them, and maintain an array of formal and informal trade barriers. My bill would apply only to nations which meet these three unusual criteria.

There is another objection which could be made to the bill—that by limiting Japanese exports to America, it would further depress the yen and make their products more competitive. This is a danger, but as many experts point out, Japan is dependent on dollar-denominated raw material imports for so much of its economy that a decline in the yen is a mixed blessing.

In conclusion, the issue of Japanese trade is the most serious trade problem facing us in the Congress. We need to tackle that problem in a different way than we have in the past, and I would ask you to consider this nontraditional approach. To stay the course, appears to be certain disaster.

Mr. Chairman, that concludes my remarks. But just to prove that I do believe in trade and competition, I would like to take one minute to urge consideration of a bill I introduced Monday on behalf of the Semiconductor Industry Association to suspend the tariffs on semiconductors as a challenge to Japan to do the same. This is a commendable initiative by the industry; they will testify on this at length. I hope you can consider the bill at your first round of small tariff bill hearings.

[An attachment to the prepared statement follows:]

[From Newsweek, January 10, 1983]

TRADING BLOWS WITH JAPAN

(By Lester C. Thurow)

America's trading deficit with Japan, now running at a $20 billion annual rate, is both economically and politically unacceptable.

With little growth in home markets, exports have become Japan's main source of economic progress. But when these exports hit a zero-growth American economy, they cut local sales and produce unemployment. The unemployment that would normally flow from a stagnant Japanese domestic economy is essentially being exported to the United States. This was acceptable when Japan had a small, weak economy and America a strong one, but it is not permissible given a large Japanese economy and a sick American one.

QUOTAS

Within the United States, the trade imbalance leads to irresistible political pressures to retreat into ever-widening circles of protection. Auto-import quotas are to be replaced with domestic-content legislation that would for all practical purposes prohibit the import of Japanese cars. Congress votes for such laws because there are simply many more voters hurt by Japanese exports than helped by being able to sell their products in Japan. In theory consumers provide a countervailing political pressure to such legislation because they would lose the right to buy cheap, high-quality Japanese products, but in practice many consumers feel that their own jobs are threatened and, in any case, consumers have little political muscle.

As the free world's economic leader, however, when America retreats into protection the rest of the world races into it. The net result is the initial skirmishing of a trade war and a collapsing world economy. Each country prohibits imports but this leads everyone's exports to fall. Since countries tend to export what they do best and import what they do worst, everyone loses a few jobs in their best industries and gains a few jobs in their worst industries. At the end of the protection road, everyone's economy is sicker than it was at the beginning. That journey is now well under way.

Americans have to take much of the blame for the trade deficit with Japan. American firms have refused to design products explicitly for the Japanese market, have been shoddy in their quality control, have refused to learn the Japanese language and customs, have demanded instant success and have often acted as if it is the duty of Japan to run its economy precisely as the U.S. economy is run.

If the United States were the only country having trouble exporting to Japan, one could say that Americans will simply have to learn how to sell their products in foreign markets. But it isn't only Americans who are having trouble. Countries such as West Germany, with demonstrated track records of exporting success, have found it extremely difficult to break into the Japanese market.

Japan is still operating its economy as if it were small and weak. Agriculture benefits from overt protection and other areas benefit from covert protection, such as expensive safety inspections. Even more important is history and custom. How does an American firm break in as a new supplier of industrial components when Japanese firms place a premium on maintaining long-term intimate supply relationships?

But we have reached the point where ascribing blame has become irrelevant. A solution is needed. Now.

OPEN DOOR

The answer is to abolish all of our current restrictions on specific Japanese exports and to replace them with a system of general reciprocity. Given world trading patterns, such as a big American surplus with Europe, America can afford to run a limited deficit with Japan. Let's assume that America could afford a $4 billion bilateral trade deficit with Japan. America would announce that Japan had unlimited access to the American market in terms of specific products but it could only export $1 billion more to the United States this quarter than it had imported from the United States in the preceding quarter. If Japan imported $10 billion worth of goods and services from the United States in the fourth quarter of 1982 it could export $11 billion worth of goods to the United States in the first quarter of 1983.

Such a system would preserve the advantages of free trade yet still be able to limit the overall deficit to manageable proportions. No one would be telling the Japanese how to run their economy. We would essentially be offering them an open door. Come into our markets. Export whatever you like. But remember, whatever you export, you have to import a comparable, even if lesser, amount.

Chairman GIBBONS. Mr. Stark, first of all I want to commend you for coming here and thinking about this problem and coming forward with some new approaches to an old, old problem that we have. Without objection, your entire statement will be included in the record.

I also want to commend you for your interest in the semiconductor industry as well as those in your semiconductor industry. They have been marked by positive thinking and constructive thinking. Perhaps one reason they have been so successful is that they have been willing to break into new frontiers of not only electronics but of knowledge in a broad, broad sense.

Does your bill to reduce tariffs cover semiconductor parts and components and final products?

Mr. STARK. As far as I know, Mr. Chairman.

Chairman GIBBONS. Does it extend just specifically to Japan or to all other nations that——

Mr. STARK. It would be to any nation that would reciprocate.

Chairman GIBBONS. Any nation that will reciprocally respond with going to zero would get zero.

Mr. STARK. Right.

Chairman GIBBONS. All right. Does it distinguish between developed nations or developing nations?

Mr. STARK. No, just most-favored nation.

Chairman GIBBONS. All right, but it is on a reciprocal most-favored-nation basis? If they go to zero, we will go to zero?

Mr. STARK. That is correct, Mr. Chairman.

Chairman GIBBONS. Well, I do not really have any quarrel with that concept.

I want to take a greater look at your other bill and I would assure you that as chairman we will certainly give you and the proponents of your second bill a greater opportunity to come in here to discuss it with us and see if we cannot understand it a little better, and perhaps work with you in developing that concept.

Mr. STARK. Thank you very much.

Chairman GIBBONS. Mr. Jenkins.

Mr. JENKINS. Mr. Chairman, I simply want to commend Mr. Stark for his proposals particularly with Japan. I agree with you that we have to seek some new approaches in the trade field. Obviously what has been occurring in the past is not working very well for the world economy.

It is extremely important that we look for new approaches to these problems, so I commend you for your proposal.

Mr. STARK. I thank the gentleman.

Chairman GIBBONS. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. I, too, would like to welcome our colleague before the committee and commend him for a rather unique approach to the problem.

I presume, Pete, that within these constraints your proposal would have the effect of lowering or eliminating nontariff barriers.

Mr. STARK. One would hope that that would be the case. Basically, in the case of Japan, let them do what they want. In other words, if that $10 billion of surplus, which is the number that was picked as the generic imbalance that exists between us, if we estimated a free trade market we would give up all of our special auto restrictions or machine tool restrictions, and say export what you will, whatever the free market will absorb.

But when you get above that $10 billion imbalance we halt until you buy enough from us.

Mr. SCHULZE. Have you given any thought to how that would happen, because, of course, the trigger would lag. You would always be behind at figuring out that imbalance. By the time you figured it, it might have been corrected.

Mr. STARK. We basically would have to be working on the previous year's figures. Thurow, in his suggestions, suggested we do it quarterly, and our feeling was that that just would not work. You would be too far behind in your calculations.

I think his article speaks to $1 billion differential in any one quarter and it just seemed to us that that would be a nightmare to calculate. So we would be working on a year in arrears, as it were.

Mr. SCHULZE. How about services? How do you think this would affect services?

Mr. STARK. Well, I suppose we have a surplus on the services side and I do not know if we address the whole issue of services. This relates to manufactured goods or merchandise trade, and your question is excellent. I had not really thought about what effect, if any, this would have on our exchange of services. Although, as you know, I have also introduced in the past bills which would promote services as an export, because I think it is a very rapidly growing part of our economy.

But I have a hunch that these do not interreact that much.

Mr. **Schulze**. How did you arrive at the $10 billion figure and would it be better to consider some kind of a percentage of overall trade rather than a flat dollar figure?

Mr. **Stark**. I guess I arrived at $10 billion the same way we picked 65 years old back in the 1930s, Dick. As I say, Professor Thurow has suggested $4 billion. There has been some testimony to the effect that $10 billion is an economist's guess as to what would be our national deficit if free trade did exist.

I would leave it to those more expert in this field than am I to decide what the exact figure would be. And if it is a percentage, if you wanted to project it for years ahead, I suppose a percentage would be better. But my guess is that this is something that has to be adjusted. The amount has to be adjusted from time to time.

Mr. **Schulze**. If it was over $10 billion you would then lock in the reciprocity tariffs?

Mr. **Stark**. We are talking about, say, a 50-percent surcharge for the next item that came in, whatever it happens to be—if it was a television set or an automobile or a piece of clothing. It would be in the aggregate.

Mr. **Schulze**. It also seems to me that you could get into transshipping problems because they transship to another country.

Mr. **Stark**. I would suspect that that exists today.

Mr. **Schulze**. It does.

Mr. **Stark**. And I do not know that this bill would solve that problem.

Mr. **Schulze**. I thank the gentleman.

Mr. **Stark**. I thank you for your consideration this morning. Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you, Mr. Stark.

Our next witness—oh, I am sorry. Wait a minute. Excuse me. I am sorry. Mr. Frenzel.

Mr. **Stark**. I thought I was home free, Mr. Chairman.

Mr. **Frenzel**. You are home.

I want to start the discussion by saying that you have an unfair advantage over the committee—the staff member on your left knows more about Japanese-United States trade than we do—so that is not fair.

Mr. **Stark**. That is correct. It may not be fair.

Chairman **Gibbons**. There is only one thing the committee is mad about, and that is that we do not have the services that you do, but we appreciate the fact that he is working hard because he always works hard and effectively.

Mr. **Stark**. I think he left his heart in the committee.

Mr. **Frenzel**. Pete, the bill you are suggesting on semiconductors is one that would remove our tariffs to any country who would similarly remove its tariff?

Mr. **Stark**. That is the idea, yes. That aspect is still in the drafting stage.

Mr. **Frenzel**. It sounds like a pretty good idea to me.

Mr. **Stark**. I think it is the first step and one would hope that most nations would step forward to come the other half of the way with us. I think we would make great strides toward the free trade that we all hope could exist.

Mr. Frenzel. Your other bill is a little more confusing to me, particularly since Mr. Thurow has described it as free trade, but it does not sound very free to me.

Mr. Stark. It is not. It is a managed trade and it seemed to me that it allows more marketplace decisions. It attempts to contain the aggregate dollar amounts within the ball parks that would exist if free trade did exist.

Mr. Frenzel. Pete, what is the advantage for us? Will we feel better? All we will do is we will cause our consumers to pay a little more dough. I assume that.

Are you offering it as some sort of an incentive to the Japanese to buy more American goods? Is that what it is supposed to be?

Mr. Stark. I think I am offering it as an alternative to what realistically you are being requested to do every day. I am requested to participate in an auto parts bill which, because I have co-sponsored it, I will not really comment on, but I would prefer my approach, suffice it to say. It is an alternative to a problem that exists not only in a trade climate but in a political climate.

Mr. Frenzel. What is the advantage to the United States?

Mr. Stark. I think the advantage to the United States is that it may be some encouragement to remove trade barriers on both sides of the Pacific. If you were dealing with an aggregate amount, you find that Japan tends to trade up, if you will, they are constantly looking for—what do I want to say—not better products but products that are more complex as they move along in trade.

Mr. Frenzel. Only when we put limits on what they can ship and they like to sell more expensive things.

Mr. Stark. Correct. As I say, I think this would take some of the artificial barriers, that when you try to go one industry at a time—and I know the gentleman opposes that. But we do not always win in this business, and it seems to me an alternative. We are then dealing with only one restriction that we would like to ultimately remove.

Mr. Frenzel. The question that that compels is, we have on occasion had a higher than a $10 billion trade balance with the EC. Should they pass a similar law for us?

Mr. Stark. You mean what would happen if they did?

Mr. Frenzel. If we are justified in passing it here, is EC justified in passing one?

Mr. Stark. They certainly could. I question whether they feel that we have the same barriers to their selling us goods out of the European economic community. That is a risk. They could require all kinds of tariff restrictions on our goods now.

Mr. Frenzel. I guess my problem is that every inefficient nation could pass such a bill, a nation that could not compete, and, therefore, have a negative balance.

Mr. Stark. But they could right now pass all kinds of tariffs that would restrict our exporting to them and I guess the only thing I can say is so far they have not.

Instead of trying to accuse people of not translating contracts or of getting into what a lifestyle is, or whether the government is subsidizing or not subsidizing—and one person's subsidy is another person's tax relief—those discussions disappear.

We will still have the problem of industries being able to compete and being efficient and sell their products. But in terms of our duty as legislators we can look at the problem in the aggregate. We do not really have to make choices as between the auto industry and the electronics industry or the textile industry and the leather goods industry. Those things will then be solved in the marketplace.

It is not suggested as a solution, if you will, to whatever the problem is. The problem is we do not sell enough and we buy too much. I do not pretend to think that we have the power to solve that problem in this committee or in the Congress, but I think that we recognize that a lot of people would like us to take it on, one nut and one bolt at a time, and I am suggesting that maybe we could do our duty, solve the political problem by looking at an aggregate solution rather than a piecemeal solution.

Mr. **Frenzel**. I think it is an ingenious attempt. I think we need to give it some more thought. I can see the Japanese automakers, for instance, building all their cars the year before and then trying to ship them all in January so that they can get in before somebody tips over the maximum.

Mr. **Stark**. I am willing to let that be their problem.

Mr. **Frenzel**. Thank you very much.

Mr. **Stark**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Thank you.

Our next witness is Mr. C. Fred Bergsten. Mr. Bergsten is director of the Institute for International Economics. I am sure all the members of the committee know of Mr. Bergsten's distinguished background both in the private sector and in the public sector.

I introduced him a while ago to a person, and I called him a "former Assistant Secretary of the Treasury for the World." And I did not mean that as a slurring remark, I meant it as a remark to describe that within the duties of the Secretary of the Treasury Mr. Bergsten had to worry about the world and its economic functionings and its relationship, the world's relationship to the United States and the United States to the world.

We welcome you here, Mr. Bergsten, to hear from you on this particular subject of our United States-Japan trade relations.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. **Bergsten**. Thank you very much, Mr. Chairman. It is good to be back.

What I thought I would try to do today—and outlined it in the statement I have given you—is to ask two questions: What really is the Japan problem for the United States in trade these days? And what should we do about it?

In testifying to you I am going to rely heavily on a conference that we held at my Institute 3 weeks ago where we had about 100 of the top experts on this topic from business, law firms, labor, academia, both congressional staff and the administration, to study this issue and try to come to some judgments as to what was the real nature of the Japan problem and what the United States could do about it.

No group of this type or any other, obviously, is fully representative, and I do not mean to suggest that there was unanimity of views even at our session. But there was a fairly high degree of consensus at that meeting, and I essentially want to report to you on that, interspersing it with a few personal comments of my own as we go along.

I should say that there were a number of papers prepared for that session, some very interesting, and those of course we would be happy to make available to the committee or anybody else, if you would like to have them.

Chairman GIBBONS. Certainly. We are going to put your statement in the record in its entirety, and you just proceed as you wish. And I would like to have access to those papers, and perhaps the staff. If you could send a set to the staff that we could see, then we could all use them.

Mr. BERGSTEN. I would be pleased to do that.

Let me tick off the analytical conclusions and then the policy thoughts that emerged from that session, and then I will conclude with some judgments of my own as to what we might do in this area of trade policy.

First, Japan is highly protectionist on agriculture. There are major problems in that area. It remains essential to keep working to liberalize Japan's barriers to food imports, albeit with perhaps diffent tactics than have been chosen to date.

Second—and this is a point that is not I think widely recognized or understood—in terms of traditional import barriers, Japan is probably less protectionist with response to industrial products than the United States or other major industrial countries. Japan's tariffs are lower. It has fewer quotas on industrial products. Its current-account position over the past 10 years has been weaker than that of the United States or Germany, suggesting that any further increase in Japanese imports would probably be matched by equivalent increases in Japanese exports and it is not clear that that would help the problem.

Indeed, contrary to what Mr. Stark was implying, someone suggested if we took off all trade barriers and went to a completely free-trade world—meaning the United States, Japan, and everybody—that Japan's surpluses would strengthen and not ours because our barriers, including the array, of course, of voluntary restraint agreements, have a much more restrictive impact on Japan's sales to us than vice versa.

One should also note that Japan's huge surplus in manufactured goods trade, which is huge, is in a sense structurally required by its equally huge deficit in all other trade—energy, other raw materials, food, services, and the like. And I think, as Mr. Stark correctly recognized in part, Japan runs structural bilateral surpluses with the United States as the obverse of its deficit with oil-exporting countries and other primary producers. Indeed, U.S. exports of manufactured goods are far higher to Japan than to Germany, although Germany's total imports are much larger in toto and Germany is widely viewed as a very open market.

So on a variety of criteria, one does have to come to the objective conclusion that in terms of the traditional tools of trade policy—and I underline that, those traditional tools—Japan is not a protectionist country and the current Japan problem is really not an issue, in our judgment, of widespread Japanese use of such devices.

Therefore, the United States should resist any temptations under the guise of reciprocity or any other rubric to levy across-the-board controls on imports from Japan. I would hasten to say that a proposal like Mr. Stark's first bill, of seeking further reciprocal reduction in import barriers, would be a thoroughly constructive and beneficial idea.

But to respond by across-the-board protectionism here, as a response to alleged Japanese use of such practices, would be misreading the situation and a mistake.

However, a third conclusion: There is at present a very major macroeconomic problem between the United States and Japan that affects this area. And that, of course, is the exchange rate misalignment, the undervaluation of the yen and the overvaluation of the dollar. We have talked about that at some length in prior hearings of this committee, most recently in November. So I will not go into detail here except to recall it, and to note that the group that met at our Institute 3 weeks ago, fully came to the conclusion that the exchange rate misalinement remains the central problem at the macroeconomic level.

I would simply update something I said to the committee in November. You will recall at that time the yen was strengthening, and it appeared to us that it might be on the way to correction. Unfortunately, as I suggested at that time might happen, the strengthening of the yen stalled out about halfway to where it needed to go. It did strengthen significantly, by about 20 percent at the maximum. It has now slid back a bit from that. I would say it has probably gone about halfway toward the correction that was needed. So there has been some improvement, but a lot more is needed.

The fourth conclusion; beyond the exchange rate, the major and potentially more structural Japan problem lies at the microeconomic level, namely, the use of industry targeting by Japan to establish global competitiveness for Japanese industry in key sectors. In a sense, the issue is not whether the Japanese market is closed or open, but rather how specific Japanese policies affect trade in particular sectors, notably sectors at the leading edge of technology where the United States is being effectively challenged on a widespread basis for the first time in the post-war period.

Now, to be sure, this Japanese targeting is neither a new phenomenon nor is it infallible, as I will indicate in a moment. Nevertheless, the efforts are clearly widespread, and they are pretty clearly different from anything attempted in this country or most other countries. And such targeting efforts do take on particular potential importance in a world of slower economic growth, greater international interdependence and, therefore, trade flows, and when there has been a reduced use of traditional measures—tariffs, quotas and the like—to limit the trade impact of domestic policies.

Now, having said that this is a very large potential problem, I would quickly note another judgment of our group; namely, that the success of Japan's industry targeting is somewhat unclear. Some observers, understandably including many of those in the industries involved, see the organized cooperation of Japanese industrial policy as a vital threat to their futures.

Others, however, including some very experienced observers of Japan, are much more skeptical. Besides recalling the traditional American view that government intervention hampers rather than promotes industrial success, they note that Japan in its industrial policy efforts has picked several industries that turned out to be losers: aluminum, refining, petrochemicals, and some others. Their targeting has failed so far with some of its anointed winners, such as aircraft, which they started promoting 30 years ago and has not gotten very far. And they have actually tried to discourage some industries which succeeded spectacularly, like automobiles.

So it is clear that Japanese targeting has not been an unmitigated success. Nevertheless, four important subconclusions emerge. One is that there are numerous specific examples of Japanese efforts in this direction, and some evidence of its success in some industries.

Second, it is unclear how much impact there is at the overall trade or macroeconomic level, raising the issue of how widespread or effective the practices might be.

And finally, though I regret to say it, I am afraid we simply do not know enough to come to very firm conclusions about the impact of Japanese industry targeting. This is probably because of a classic analytical dilemma. We know the Japanese have succeeded in a lot of industries, but we do not really know whether it is simply the hard work and undoubted competitiveness of Japan on all the usual economic criteria, or whether it is its industrial policies and government business collaboration that have been important.

Interestingly, you will get very different views on that from the Japanese. I have talked to a number of leading private Japanese businessmen and economists in the last week or so, and most private Japanese tend to denigrate the importance of Japanese industrial policy or government support, arguing that that is simply something that the MITI bureaucrats like to pat themselves on the chest and take credit for whereas in fact it has been the hard work and competitiveness of the private sector. So there is a big dispute on this, I think honestly so, within Japan as well as in the United States.

I would note a recent comment made by Ambassador Brock, which I thought was extremely perceptive. Ambassador Brock said he has a nightmare that the Japanese do everything the United States asks them to do overnight and there is absolutely no change in the results. This implies that we really do not know the impact of these policies on the trade flows and the bottom line outcome in our trade relations with Japan.

It is clear we need a lot more study of the problem, especially concerning the relationship between macroeconomic elements like the exchange rate and microeconomic factors like Japanese industrial policy, in trying to assess what is the nature of the problem.

Now, having said this, and raising some doubts about the net effect of Japanese industry targeting, I would go on to say that it is clear that Japan does operate very differently from the United States and most other countries in a number of areas that affect trade. Many of its key institutional arrangements—the role of government, the financial system, the existence of the industry groups and trading companies, the distribution system, a variety of institutional practices—all those are clearly illiberal by our standards and very different from the way we and most other countries operate their economies.

Chairman GIBBONS. Would you repeat that?

Mr. BERGSTEN. The point is that there is a very big structural difference in many of the key Japanese institutional arrangements that affect their economic performance and their trade, different from ours, the Europeans, or in fact most countries around the world. And I cited the financial system, the existence of industry groups—the so-called Keiretsu, the trading companies.

One might mention, as you have here in the committee many times, the belated and incomplete liberalization of their capital markets, the international role of the yen, bidding procedures in a number of components of public procurement in Japan, the treatment of labor as a fixed cost rather than as a variable cost in industry.

There are a lot of structural differences between the modus operandi in Japanese industry than what we are used to here. And those differences, simply because they are different, raises questions of legitimacy. It raises a suspicion that these devices are somehow unfair and give Japan a unique competitive advantage.

This was a topic we discussed at great length at this meeting I held 3 weeks ago, and there was a raging debate on the topic. Some felt that the Japanese institutions were simply alternative ways of doing things to our own ways and that on balance they did not have a net protective effect or even a mercantilist effect or provide net support for Japanese industry. In fact, some argued that the practices were disadvantageous to Japan in some of its economic practices.

On the other hand, there are those who argue that these Japanese practices essentially are add-ons to the normal kinds of things we are used to and provide special additional government support and modes of improving Japan's competitive position vis-a-vis the United States and others and therefore give them an unfair advantage.

Again, frankly, no net conclusion was possible, because we do not know enough. But it is a raging debate, and I think goes to the central issue of what is the Japan problem and whether there is something unfair and unique in Japan's ability to compete in world trade.

Another conclusion which relates closely to that was that, to the extent that the different Japanese institutions and practices do affect trade, they may not be very susceptible to the traditional responses of U.S. trade law and the GATT.

Many people believe that the kinds of practices I mentioned, including some of the key components of industrial policy and targeting, were never even contemplated by the framers of U.S. trade law or the GATT and would be extremely difficult to fit into the traditional mold.

The question, therefore, is whether our current laws and institutions apply in an effective way to the kinds of problems that I am focusing on here as the central problems in the trade relation: industrial policy, targeting, and unique Japanese institutional arrangements and practices which may affect trade and economic flows.

The final analytical conclusion was to say that, despite all these ambiguities and uncertainties, clearly we all recognize that there are acute tensions in present and foreseeable economic relations between the United States and Japan, with bottom line results in terms of trade balances, trade flows, job effects and such, which are much too significant to be ignored.

Even the improvements in unemployment and overall trade and current-account balances which would emerge from correction of the currency misalinement and economic recovery in this country, while they would lessen the degree of tension significantly, probably would not obviate the whole problem nor some of the sector-specific problems like semiconductors, machine tools, large computers which carry important security as well as economic implications.

So further policy steps may be necessary, although it was our view that continuing to focus on opening Japan's market to specific U.S. products, what one might call the beef and citrus syndrome, is only one element of a much larger and more far-reaching problem.

Finally then, what to do about it, given this picture of somewhat ambiguous and conflicting evidence on what is the problem and what is its impact on the United States. Any successful U.S. approach to dealing with the Japan problem of course has to include U.S. steps to improve our own economic performance, and it has to include U.S. action to deal with key issues when we have the capacity to do so, such as the exchange rate, instead of just sitting back, ignoring the problem and calling on the Japanese to change.

Clearly, we have to take steps ourselves, both to promote the desired outcomes and be credible in our approaches to Japan. Likewise, the Japanese will have to recognize much further than they have the very great impact of their actions on the whole international economic system; and therefore, they are going to have to adopt a much greater leadership role and more active and globally oriented trade and economic strategy.

But beyond those broad questions, four alternative policy approaches emerged from the discussion we had. I would like to share them with you, albeit in somewhat cryptic form. First was for the United States to emulate Japan. The United States could begin to take a longer-run view of our overall economic future and the future of specific U.S. industries and, in that context, start to provide positive support, particularly for some high-technology sectors, perhaps somewhat along the lines of the Japanese model.

One can look at a number of specific components that might fit into that area: preferential financing; better tax treatment; assured markets; perhaps limitations on antitrust application regarding R&D, for example; and even protection from imports at an early stage of an industry's development.

There are obviously major problems in the U.S. context from going this road. There are intellectual and political difficulties of trying to pick winners, and any effort in that direction would clearly represent a sharp break with the market-oriented traditions of this country and the arm's-length relationship among business, labor, and government.

On the other hand, it does need to be noted that the United States has targeted particular industries and goals in the past. Military aircraft and computers, landing on the moon, most recently the space shuttle, and the entire agricultural sector for a century. Indeed, part of any reasoned U.S. response to Japanese targeting must begin with a recognition that the United States itself has carried out such efforts, albeit in recent times primarily for national security rather than more purely economic reasons.

There are already some modest moves in this direction. You were very much involved in the legislation to create export trading companies, which as you will recall, started out in some people's minds as an emulation of the Japanese trading companies. So we do see some movement in that direction.

I do not know that it could occur at a pace or extent that would go very far toward emulating Japan, but it is one possible approach in dealing with the kinds of problems I have mentioned.

The second approach: induce Japan to emulate us. Many of these illiberal Japanese institutions, illiberal in our terms, are under attack within Japan itself. And some of them, such as the capital markets, international use of the yen, are already changing, a more rapid——

Chairman GIBBONS. Can you interrupt a minute? We have a mob scene going over there, and it is a little disruptive.

[Discussion off the record.]

Chairman GIBBONS. Go right ahead, Mr. Bergsten.

Mr. BERGSTEN. Under the heading of inducing Japan to emulate us, one specific example, of course, would be a Japanese statement that they would no longer target specific industries in the way they have done or would at least pledge to take full account of the effects on other countries when they chose to do so. Something like that could widely affect both realities and the perceptions about these differences between the United States and Japan and go a long way to help deal with the problem.

At the same time, the Japanese can legitimately ask why they should be asked to change institutions deeply rooted in their society, especially when the net impact of some of those institutions on trade and the rest of the world remains unclear.

A third alternative is to try to create some new international rules of the game to comprehend the impact on trade and overall economic relationships of institutions and practices going well beyond the traditional scope of trade policy. Whatever happens with Japan, such a major leap in international jurisdiction may be necessary anyway. France carries out industrial policy efforts of this type. A number of the newly industrialized countries do it. The nonmarket economies clearly do it, if less spectacularly than Japan.

A start was made in this direction in the Tokyo round where previously sovereign issues—domestic subsidies, government procurement, national industrial standards—were brought within the purview of the GATT and the international rules of the game. As we know from that experience, any such extensions of international jurisdiction would be, at best, a lengthy and halting process. But it may be that part of any solution to the Japanese practices in this industrial policy area, which go beyond Japan, may require some significant changes in the international rules of the game.

The fourth and final option that we adduced is unilateral retaliation, which is one I think Mr. Stark had in mind, at least in part, in his second proposal. This approach would rest on the view that some Japanese competition is simply too much to take, whether it is fair or not, in defense of basic U.S. interests, it would have to be countered whether or not permitted under the existing international rules or even under current U.S. law.

One way to do that would be countervailing duties against Japanese practices. It is a little more difficult to carry out in third markets where one would presumably have to create some matching subsidies, as has been done recently in the case of some agricultural products. I would note that criteria for action of this type are extremely elusive, therefore, such an approach runs the risk of somewhat arbitrary and thus highly political implementation. Nevertheless, I think one does have to lay it out as a possibility, given the degree of difficulty and the degree of perhaps moving ahead as fast as we would like.

Now, finally, let me sum up and indicate a few personal thoughts on how we might best proceed at this point in time. I do so, incidentally, on the assumption that neither the United States nor Japan is going to change its basic economic and social structure very substantially in the near future. So we will have to look elsewhere for viable policy options at least in the next few years.

First, I would remind us that in dealing with Japan it is always critical for the United States to get its act together. We must be clear about what we want both in terms of overall priorities and fairly specific components of those priorities; for example, which tools of Japanese industrial policy are of concern to us.

History shows, and my own experience would certainly support the view, that Japan does respond positively, albeit sometimes grudgingly and slowly, when the United States is clear and unified in its efforts toward Japan.

In my judgment, we should now reduce the priority that has recently been attached to opening up the Japanese market, not forget it but give it a lower priority, and focus on two issues: correcting the exchange rate misalignment at the macroeconomic level, and reaching agreement on what to do about industrial targeting at the microeconomic level.

Second, and related to that, resolution of the exchange rate problem, of course, remains critical. Fortunately, it may become more susceptible to resolution soon because a sizable decline in the price of oil along with the growing U.S. current-account deficits and growing Japanese current-account surpluses would tend to strengthen the yen substantially, perhaps all the way to the needed range of somewhere between 180 and 200 to 1, just as the two big upside oil shocks in the 1970's severly weakened the yen.

Once the yen does begin to strengthen in the markets, as it did from early November through early January, there clearly ought to be a change in U.S. policy to come in with joint intervention in the markets and some judicious official statements to encourage the yen to reach the needed levels.

I think a golden opportunity was missed when Prime Minister Nakasone was here. A few statements by Japanese and U.S. officials together on that occasion, noting that the yen had been strengthening and that that was a wholly desirable development that was to be encouraged and we would expect and welcome further movement in that direction, perhaps backed up with a little joint intervention to that end, could have pushed the yen to 200 to 1 by now. It was a major error to have missed that opportunity. I hope once the markets begin again to push the yen up, that the opportunity will not be missed once more.

However, if U.S. interest rates started to go back up and pull the dollar back up, then it would be again particularly critical for international as well as domestic reasons for you in the Congress as well as the administration to mount a major assault on those outyear deficits in the government budget in order to take the pressure off interest rates and thereby, along with a better domestic outcome, permit the needed currency correction.

Going beyond the exchange rate, my third concluding point would be that the United States should now greatly intensify the dialog that has already begun with Japan on the closely related issues of industrial policy and targeting. The administration has worked out with the Japanese a so-called High-Technology Committee which does provide at least a starting base to talk about these issues. Through that forum and others it should now be made clear that this issue, industrial policy targeting, is the major trade policy concern of the United States with Japan and that Japanese cooperation is necessary in that area to head off the threat of major reaction here in the United States and probably elsewhere.

At the same time, I would caution that we should avoid building excessive expectations domestically of the likely outcome in light of our inadequate knowledge of the depth of the problem and thus how much may result from the effort. But I think this is the major area to pursue now.

Fourth, I would offer a guiding principle for those discussions, a principle that would suggest that infant industry protection—the kind of protection that countries have historically put into place to support their nascent industries that they wanted to promote over time—is unacceptable in mature industrial economies. The Japanese could argue, maybe as recently as 20 years ago, that they were a latecomer and, therefore, justified in giving special preferential and supportive treatment to their burgeoning industries. But I think any such claim would be erroneous today.

In that context, one would have to define protection as broadly including the panoply of practices which make up industrial policy and industry targeting. The key issue, of course, would be to decide which practices were to be barred under this concept and which would remain legitimate. Such discourse I think would inevitably lead to sophisticated and subtle discussions of what constitutes illegitimate subsidies and other forms of industry support. It might lead to some criticism of U.S. practices in some areas, as well as practices of Japan, France, and others, but I think it is the way to go in trying to deal with this emerging problem that is at the center, I believe, now of the trade issue with Japan.

Fifth, the United States might have to underscore its seriousness of purpose in this area by countervailing against some Japanese products where subsidies can be clearly distinguished in Japanese practice. It might even be desirable to ultimately change the relevant U.S. statutes and the GATT, to relate the amount of a countervailing duty not just to the size of the subsidy itself but to some analytical measure of the damage to the industry involved. That would be a big step in terms of U.S. law and international rules of the game. It is fraught with difficulty at the intellectual level, not to mention risk of political abuse, but it may be an essential component of how to deal with these problems in the industrial policy area.

In permitting such an approach to be carried out, U.S. industries that want such relief would have to undertake extensive and quite sophisticated analyses to determine both the existence of subsidies and the injury they have caused, as one or two U.S. industries have commendably already attempted to do.

However, I want to stress that any such adoption of new import moves by the United States should be rifle-shot responses to very specific industry problems. As I pointed out at the outset, any shotgun proposals for erecting widespread barriers against imports from Japan are unjustified and should be rejected.

Finally, I think these issues of industrial policy and targeting should be now submitted for serious study to the GATT, particularly the Subsidy Code Committee, to start developing thinking that would surely be needed at some point, perhaps in the next big multilateral trade negotiation, to enable the international rules to cope more effectively with the Japan issue and the growing incidence of problems of that type. Japan itself, I would think, would welcome such an effort and participate fully in it.

In conclusion, Mr. Chairman, as usual, the United States needs to forge a sophisticated, multifaceted response to the Japan problem, going into monetary affairs and industry-specific problems as well as the traditional tools of trade policy. But since Japan is so central to overall U.S. trade policy, that response will go far to determine the course of overall U.S. trade policy over the coming years.

I would hope that our efforts at the Institute to contribute to that process, both in conveying the results of our recent conference and in future research we will be doing will be helpful in dealing with the problem. Thank you.

[The prepared statement follows:]

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

BACKGROUND

On February 16, the Institute for International Economics held a day-long seminar on "the Japan problem" and a related evening session which specifically addressed the challenges posed by Japan to the United States high-technology industries—which are obviously central issues of U.S. trade policy in 1983 and beyond, as indicated by the decision of the Committee to hold these hearings. The sessions were attended by about one hundred experts on the issue from the administration, Congress, a wide spectrum of U.S. business, labor, law firms, academia, and the media.

No group can claim to be fully representative on this issue, and there was no unanimity of views at our session. But the meeting produced a number of widely agreed conclusions on the nature of "the Japan problem" and proper responses for United States policy, which I want to share with you on the view that they may contribute significantly to your deliberations and the overall policy debate. It should be stressed at the outset that this is my personal summary of the discussion of February 16, to which a few of my own ideas are added, and should not be construed as committing any of the participants at that session to either overall conclusions or specific points along the way.

ANALYTICAL CONCLUSIONS

1. *Japan is highly protectionist on agriculture.*—So are most other countries, though the degree of farm protection in Japan is sharply higher than in the United States or even the European Community. [1] Even though Japan ia already the largest extenal market for United States agriculture, it therefore remains essential to continue working to liberalize Japan's barriers to food imports—albeit perhaps with somewhat different tactics then chosen to date.

2. *In terms of traditional import barriers, Japan is less protectionist with regard to industrial products than the United States or other major indistrial countries.*—Japan's tariffs are lower. It has fewer quota on industrial products. Its current account position over the last 10 years has been weaker than America's or Germany's, further increases in Japanese imports are thus likely to be matched by equivalent increases in Japanese exports. Some would suggest that an elimination of all overt Japanese and American trade barriers would strengthen Japan's trade balance, not ours.

Japan's huge surplus in manufactured goods trade is required by its huge deficit in all other trade (energy, other raw materials, food, services). Likewise, it runs structural bilaterial surpluses with the United States as the obverse of its deficits with oil-exporting countries and other suppliers of primary products. The "low share" of manufactured goods in Japan's total imports may be explainable by the traditional variables of trade determination—absence of resources, highly skilled labor, geographical remoteness. United States exports of manufactured goods are far higher to Japan than to Germany, though Germany is a much larger importer in toto and is widely viewed as a very open market.

It is possible that Japan will resort to traditional import barriers in the future to protect some of its declining industries. However, the current "Japan problem" is not an issue of widespread Japanese use of such devices. The United States should thus resist any temptations—under the guise of "reciprocity" or any other rubric—to levy across-the-board controls on imports from Japan.

3. However, there is at present—and has been on several occasions in the past—a major macroeconomic problem: the undervaluation of the yen/overvaluation of the dollar. This currency misalignment is the primary source of overall United States-Japan economic friction, as it has been on two other occasions over the last dozen years. Its correction is urgent, and continues to be ignored by the administration.[2]

4. *Beyond the exchange rate, the major and potentially more structural "Japan problem" lies at the microeconomic level: the use of "industry targeting" to establish global competitiveness for Japanese industry in key industrial sectors.*—The issue is not whether Japan's market is open or closed, but rather how specific Japanese policies affect trade in particular sectors—notably, sectors at the leading edge of technology where the United States is being effectively challenged on a widespread basis for the first time. To be sure, this targeting is neither new nor infallible (see below). Nevertheless, it is clearly widespread and clearly different from anything attempted in this country (or most others) and it takes on greater potential importance than before in a world of slower economic growth, greater international interdependence, and reduced use of traditional measures to limit the trade impact of domestic policies.

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[1] It is estimated by Fred Sanderson of the Brookings Institution that the consumer costs and net budgetry support of agricultural programs in 1978-80 totaled 140 percent of world prices in Japan, 67 percent in the EC and 15 percent in the United States. See *Agricultural Protectionism: Japan, United States and the European Community*, Japan Economic Institutes, February 1983.

[2] For details, see my "The Dollar, the Yen and U.S. Trade", testimony presented to this Subcommittee on November 30, 1982. As I feared at that time, the strengthening of the yen then underway stalled in mid-January about halfway to the needed level and has not corrected further since. A golden opportunity was missed to build on the market move from 278:1 to 227:1; I believe that joint intervention and a few official statements (e.g., during the visit of Prime Minister Nakasone to Washington) might well have been able to move the yen to 200:1 or so by now had it been attempted.

The success of Japan's "industry targeting" is, however, unclear.—Some observers, understandably including many of those in the industries involved, see the "selective protectionism" and "organized cooperation" of this policy as a vital threat to their futures. Others, including some very experienced observers of Japan, are much more skeptical; because recalling the traditional American view that government intervention hampers rather than promotes industrial success, they note that it has picked several industries which turned out to be "losers" (aluminum refining, petrochemicals), failed so far with some of its anointed "winners" (e.g., aircraft) and actually tried to discourage some which succeded spectacularly (e.g., automobiles [3]). Four subconclusions emerge:

a. There are numerous specific examples of Japanese efforts in this direction, and some evidence of its success in some industries.

b. It is unclear how much impact there is at the overall trade or macroeconomic level, raising the issue of how widespread the effect of the practices may be.

c. We simply do not know enough to come to firm conclusions. This is partly because of a classic "analyst's dilemma": Japan's repeated industrial successes can be explained either by its overall work ethic and undeniable competitiveness or its industrial policies and government-business collaboration, and it is extremely difficult to sort out the relative importance of any single factor. Ambassador Brock may have been right when he suggested that the bottom line might not change even if Japan adopted every policy change urged on it by the United States, but we really do not know.[4]

d. We therefore need much more study of the problem, especially concerning the relationship between the macro and micro elements of Japan's success. However, it may be that we will never come to a fully satisfactory answer to the question—because it may be inherently unanswerable.

6. It is clear, however, that Japan operates very differently from the United States (and most other countries) in a number of areas that affect trade flows. Many of its key institutional arrangements—the role of government, the financial system, the existence of the industry groups (Keiretsu) and trading companies, the distribution system, the widespread existence of cartels, the treatment of labor as a fixed cost, the belated and incomplete liberalization of capital markets and the services sectors along with bidding procedures in several components of public procurement—are clearly "illiberal" by our standards. These practices raise questions of the legitimacy of Japan's participation in the international trading system, when its underlying practices are so different from those of most other participants. However, there is a great debate as to whether these institutions simply substitute for those with which we are familiar and thus have little or no net effect on trade, or whether they supplement the more familiar approaches and thus represent an additional spur to Japanese competitiveness. Again, the jury is out and more analysis is needed—incidentially, both here and in Japan.

7. To the extent that these different Japanese institutions and practices do affect trade, they may not be very susceptible to the traditional responses of U.S. trade law and the strictures of the GATT. Some observers believe that countervailing duties could be widely applied against Japanese "subsides," if detailed analysis suggested that the various Japanese practices could be demonstrated clearly to affect trade. However, many others note that the kinds of practices (including institutional arrangements) cited above—including some of the key components of industrial policy and "targeting"—were never contemplated by the framers of either U.S. or international law in this area, and would be extremely difficult to fit into the traditional mold. They note especially the problem of adequately "countervailing," or otherwise responding, to a practice whose economic impact today is admittedly modest but which could make a major difference in market penetration a decade hence—or of responding effectively after the latter event has occurred.

8. Despite the ambiguities and uncertainties cited, there are acute tensions in present and foreseeable economic relations between the United States and Japan. The bottom-line results are much too significant to be ignored. Even the improvement in overall trade and current account balances which would emerge from cor-

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[3] A fascinating account can be found in Davis Dyer, Mark Fuller, Malcolm Salter and Alan Webber, *The Wreck of the Japanese Auto Industry,* a Research Project of the Harvard Business School, December 1982, esp. pp. 7–8.

[4] Herein arises another "analyst's dilemma." Japan has frequently responded to United States proposals to liberalize its import regime or take related steps. Frequently, however, the United States has been dissatisfied because the Japanese surplus (or specific industry problem) remained. Two intepretations are possible: that the previous barrier had no effect so that its elimination had no effect, or that the Japanese always found a substitute to maintain the previous protection. Sorting out the real outcome in such a case is, again, extremely difficult.

rection of the currency misalignment and economic recovery in this country, while it would lessen the degree of tension, would not obviate the several sector-specific problems—some of which (e.g., semiconductors, machine tools, large computers) carry important security as well as economic implications. Indeed, there is evidence that this issue might even play a role in the 1984 election campaign. Further, perhaps major, policy efforts are necessary—though opening Japan's market to specific U.S. products ("the beef and citrus syndrome") is only one element of a much larger and more far-reaching problem.

POLICY CONCLUSIONS

What, then, is likely to be a successful United States approach to dealing with "the Japan problem" as defined above? Any such approach will of course have to include U.S. steps to improve our own economic performance and decisions to deal with key issues when we have the capacity to do so (such as the exchange rate), rather than simply calling on Japan to change, both to promote the desired substantive outcome and to be credible in our approaches to the Japanese. Likewise, Japan will have to recognize even further the very great impact of its actions on the whole international economic system, and therefore adopt much more cosmopolitan approaches and a growing leadership role.

Beyond these very broad questions of national strategy, and beyond the exchange-rate issue (which has been discussed in detail here before and to which I will return briefly in a moment), four basic alternatives emerged from our meetings on February 16.

9. *Emulate Japan.* The United States could begin to take a longer run view of its overall economic future and the future of specific U.S. industries, and provide positive support for some high-technology sectors along the lines of the Japanese model. Such support, at least in the early stages of development of such industries, could include: preferential financing, better tax treatment, an assured market and (perhaps) protection from imports and limitations on antitrust application (e.g., regarding joint R&D).

The major problems, in a U.S. context, are the intellectual and political (equity) difficulties of picking "winners" and the sharp breaks with market-oriented tradition and arm's length relations among business, labor, and government. On the other hand, the United States certainly has "targeted" certain industries or goals in the past: military aircraft and computers, landing on the moon and most recently the space shuttle—and the entire agricultural sector for a century. (Indeed, part of any reasoned United States response to Japan's targeting must begin with a recognition that the United States has itself carried out such efforts, albeit primarily for national security rather than "purely economic" reasons.) There are already some modest United States moves in this direction; the legislation to authorize export trading companies, for example, began as an effort to emulate the similar Japanese entities.

10. *Induce Japan to emulate us.*—Many of Japan's "illiberal" institutions are under attack within Japan itself, and some (e.g., the capital markets and international use of the yen) are already changing. A more rapid and widespread pace for such change—including, for example, a Japanese statement that they would no longer target specific industries, or would at least take full account of the effects on other countries when they chose to do so—could widely affect both realities and perceptions. On the other hand, the Japanese can legitimately ask why they should be asked to change institutions deeply rooted in their society—especially when the net impact of those institutions on trade and other countries remains unclear.

11. *Create new international rules to comprehend the impact on trade (and overall economic relationships) of institutions and practices going well beyond the traditional scope of "trade policy".*—Whatever happens with Japan, such a quantum leap in international jurisdiction may be needed anyway if an open international economic system is to be preserved; France, a number of newly industrial countries and the non-market economies raise somewhat similar issues, if less spectacularly. A start was made in the (aptly named) "Tokyo Round," where previously sovereign issues—such as domestic subsidies, government procurement and national industrial standards—were brought within the purview of the GATT. As indicated by that experience, however, any such extension of international jurisdiction would be—at best—a lengthy and halting process.

12. *Unilateral retaliation.*—Euphemistically referred to by some as "placing a buffer" between the United States and Japan, this approach rests on the view that some Japanese competition is simply too much to take—whether "fair" or not—and, in defense of basic U.S. interests, must be countered whether or not permitted by

the existing international rules (or U.S. law). Countervailing duties would be one way to implement this option in the U.S. market, matching subsidies a technique for third markets. However, criteria for action are extremely elusive; as usual, such an approach runs the risk of somewhat arbitrary (and thus highly political) implementation.

A SUMMING UP

It is unusually difficult to know just how to proceed on these issues in light of the ambiguities and complexities sketched above. We clearly need to know more, but equally clearly there is widespread pressure to move quickly. Let me close with a few personal suggestions as to how to proceed now, while improving the basis on which to act in the future by intensifying our studies at the several points already noted. I do so on the assumption that neither the United States nor Japan is going to change its basic economic and social structure very substantially in the near future, so that we will have to look elsewhere for viable policy options.

First, in dealing with Japan it is always critical for the United States to get its act together. We must be clear about what we want, both in terms of overall priorities and fairly specific components of those priorities (e.g., which tools of Japanese industrial policy are of concern). History shows that Japan does respond positively, albeit sometimes grudgingly and slowly, when the United States is clear and unified in its efforts. In my judgment, we should now reduce the priority recently attached to the "opening of the Japanese market"—which has after all yielded three liberalization programs during the past 2 years—and focus on (a) correcting the exchange-rate misalignment at the macro level and (b) reaching agreement on what to do about "industrial targeting" at the micro level.

Second, resolution of the exchange-rate problem remains critical. Fortunately, it may soon become more susceptible to resolution because a sizable decline in the price of oil—along with the growing U.S. current account deficits and growing Japanese current account surpluses—would tend to strengthen the yen substantially, perhaps all the way to the needed range of 180:1 to 200:1, just as the two upside oil shocks severely weakened the yen. Once the yen again begins to strengthen in the markets, joint intervention and judicious official statements should be able, if needed, to encourage it to reach about 190:1—a move of about 20 percent from current levels, about the same as occurred through market action from early November to early January. However, if these events do not materialize and/or if U.S. interest rates start to climb again and thereby further strengthen the dollar, it will become critical for international as well as domestic reasons to mount a major assault on the outyear budget deficits in order to take the pressure off interest rates and thereby inter alia permit the needed currency correction.

Third, the United States should continue and intensify the dialogue already begun with Japan on the closely related issues of industrial policy and targeting. It should be made clear that this is the major trade policy concern of the United States, and that Japanese cooperation is necessary to head off the threat of major protectionist action in the United States (and probably elsewhere). At the same time, we should avoid building excessive expectations domestically of the likely outcome in light of our inadequate knowledge of the depth of the problem and thus how much may result from the effort.

Fourth, the guiding principle should henceforth be that "infant industry protection is unacceptable in mature industrial economies." Japan may have been a "late comer" and hence had a case for such protection as recently as two decades ago, but certainly cannot claim such status today. In this context, "protection" would be broadly defined to include the panoply of practices which make up industrial policy and "industry targeting." The key issue, of course, would be to decide which practices were to be barred under this concept, and which would remain "legitimate." Such discourse will inevitably lead into (hopefully) sophisticated and subtle discussions of what constitute illegitimate subsidies and other forms of industry support—and perhaps some criticism of United States practices as well as those of Japan, France, and others.

Fifth, the United States should underscore its seriousness of purpose by countervailing against Japanese products where subsidies can be clearly distinguished in Japanese practice. It might even be desirable to ultimately change the relevant U.S. statutes and the GATT, to relate the amount of the duty to an analytical measure of the damage to the injured industry, rather than simply to the size of the bounty itself. In any event, U.S. industries which want such relief will have to undertake extensive analyses to determine both the existence of subsidies and the injury they have caused, as one or two have already attempted to do. However, any such adoption of new import restraints by the United States should be rifle-shot responses to very specific industry problems; as pointed out at the outset, any shotgun proposals for erecting widespread barriers against imports from Japan are unjustified and should be rejected.

Sixth, these issues of industrial policy and targeting should be submitted for study to the Committee of Signatories to the Subsidy Code and perhaps other GATT bodies for consideration, to help develop thinking which will surely be needed at some point—perhaps in the next "MTN"—to enable the international rules to cope more effectively with the growing incidence of "Japan problems." Japan itself should welcome such an effort, and participate fully in it.

As usual, the United States needs to forge a sophisticated and multi-faceted response to "the Japan problem." Since Japan is so central to overall U.S. trade policy, that response will go far to determine the course of U.S. trade policy over the coming months and years. I hope that the Institute's efforts will contribute to that process, both in conveying the results of our recent conference and in the future research we will be doing in various aspects of the topic.

Chairman GIBBONS. Mr. Bergsten, I want to commend you for your very thorough and analytical approach to the United States-Japanese problem and to our world trade problems. I sometimes feel overwhelmed not only with the rapidity with which you speak, but with the depth of understanding that you have of these problems. I am going to have to go back and study your statement more before I can thoroughly digest it.

But let me just kind of ramble around for a while here. As I look at the yen, it is responding to market perceptions of the Japanese economy and market perceptions of the U.S. economy and other economies. The currencies are floating.

The small hearings that we have had so far tend to show that there has not been any effective intervention in this market phenomenon. As I understand it, as I read it, the people who have to live or die make a living or go broke by exchanging currency, and it is a dangerous operation to live in, even when you have got something as large as the U.S. Treasury and the Federal Reserve behind you, as you know, they betting on the U.S. economy and not on the Japanese economy. Why?

Mr BERGSTEN. There are a number of reasons that fall short of what I would regard as long term betting on one economy or another. Most research on the motivations for currency movement suggest that, in the short run, they respond to fairly transitory factors; interest rate differentials and changes in interest rate differentials, and international political uncertainties which always highlight the safe haven virtues of the dollar and the United States and bring money in.

Interestingly, the more big money managers I have talked to around the world in the last month or so, the more that safe haven factor is cited. There is lots of uncertainty around the world about the course not only of economic events but political events. There was uncertainty about the recent German election and what that would mean for Germany in the future. There was much uncertainty both before and after the latest French election as to what would happen to that economy.

All the debt problems throughout the developing world have produced capital flight from most countries when they could get money out, and that has mainly gone into the dollar. So the safe haven appeal of our currency, because of a longer run safety factor, has led many investors apparently to not even worry too much about relative yields. They do not worry too much about return on capital over time, but want to be sure it is safe.

Chairman GIBBONS. Well, while we are not doing everything right, we are probably doing more things correctly than others? Is that what you are saying?

Mr. BERGSTEN. There is no doubt about that. I think the view is justified that, over the long haul, the United States is by far the safest haven. Therefore, as long as those uncertainties continue, the dollar will be a magnet for investors around the world.

The problem, that emerges, of course, as you well know, is the impact that has on our competitive position in world trade. Our comparative advantage in security and selling financial assets gives us a disadvantage in trade in both manufactured products and services items, and costs us jobs, GNP growth and the like, while at the same time providing an influx of capital.

So it is a trade-off that has some benefits, but also some disadvantages.

Chairman GIBBONS. What you are saying is in a world of 4½ billion people, you cannot have everything.

Mr. BERGSTEN. That is right. There are historical examples such as Britain, for many years when it was the world's financial center and was regarded as the world's leader in the military as well as the economic sense where capital came in, took advantage of both excellent financial markets and a sense of security but bid up the currency and greatly disadvantaged the country's industrial base and its economic performance.

Britain was a lot more susceptible to that than we are, since it was a much smaller country and much more heavily involved in trade, but we do have a historical example where it happened.

Chairman GIBBONS. I could not blame that all on the currency traders; I would have to blame a lot of it on the fact that Britain is very small, it has very few resources, it has notoriously poor labor-management relationships and has a perpetual leisure class in it that thinks that leisure is an inherited right. All those things do not really exist in our country, as I see it. I realize that the money traders may have thought that London was a good, safe, convenient, comfortable place to put their money, but Britain, while we have the same political objectives, has a much less efficient economic system than we do.

I like those four different options you had there. Obviously, we do not want to follow the Japanese. What they are doing would be abhorrent to the ideas that we have, and I think really would lead us into sort of a class warfare in society that we would never get over. We cannot anoint a favorite industry very successfully unless we do it under the guise of national security and push it to the exclusion of all others.

I suggest that is not the American way and I do not think it is a very productive way. I think you are right to point out that the Japanese have been trying to push aviation for 30 years and they have not had much success. They tried to downplay automobiles and did not succeed in that.

But what chance or opportunity do we have to improve the international rules, given the kind of suspicion and lack of leadership that we find in the international area? We have no one who is willing to lead, who is willing to sacrifice. We have got no one who is willing to put forth the brave, new ideas about how to organize this planet.

What is the chance of us really pushing forward in that area?

Mr. **Bergsten**. I would be afraid that in the short run, Mr. Chairman, I would have to agree with you. In fact, we have recent evidence, because there was an effort to make something significant out of the GATT ministerial meeting last November. Ambassador Brock from this country was the hero of that story. I think he made a major and valiant effort to use that GATT ministerial to trigger the start of a process that would, at least in part, represent the leadership that you call for.

I do not think he got enough support, frankly, from the rest of the U.S. Government, including at the top levels. He certainly did not get much support from the rest of the world. So, at the moment, one could not be very optimistic in the short run.

I continue to feel, however, that over a little longer run period, going a few years out, there will be widespread recognition that the current situation which is adrift, and erosion of the trading system toward more protection away from the system of the postwar period, will be just too costly to permit to continue.

I say that because all of the major countries have become much more interdependent. They rely much more on trade and external economic forces than they ever have in the past, and they simply cannot afford a collapse of the international trading system. They do recall what happened in the 1930's, and I think, as they perceive the erosion, they will take steps in the right direction.

I make an analogy with the financial situation, which is not by any means all corrected either, but let me remind you of some recent developments.

Up until about 8 months ago, the current administration here was fairly caustic in denigrating the International Monetary Fund, the World Bank, international financial cooperation of the traditional type. All of a sudden, with the onset of the Mexico crisis and the worldwide debt scramble, suddenly they discovered that the IMF, the BIS, the swap networks, the international cooperative framework for financial arrangements was crucial and of central importance to U.S. national interests. Their attitude shifted and now they are leading the battle, quite correctly, for a big increase in resources at the IMF, expansion of the general arrangements to borrow, et cetera.

Realities do come home to roost and lead to changes in attitudes and policies.

We have not yet had a critical turning point like that in the trade area. I hope we do not have one, but it is always harder to recognize a gradual erosion of a system than it is when you face a crisis and look over the abyss, as they did with Mexico one weekend in mid-August. But I think the recognition will set in, both in this country and abroad, and once we get some economic recovery, perhaps helped along by a sharp decline in oil prices, and once we get these monetary imbalances corrected and, therefore, have a stronger monetary basis for trade policy, then I think we may again have the possibility at least for getting the kind of leadership that you quite rightly call for.

I think it is inevitable; it will come back. It did so in the sixties, it did so in the seventies, both times under tough conditions, and I think it will in the eighties, albeit not as quickly as I would like to see.

Chairman **Gibbons**. I am not going to monopolize this conversation any longer. Let me go to Mr. Jenkins.

Mr. **Jenkins**. Thank you, Mr. Chairman. I want to thank you for your testimony. You indicated there are some problems and also some benefits as far as the influx of capital into this country. It appears to me what you are saying in the analogy between the present situation and Great Britain, is that the greatest beneficiary is the financial community itself, is it not, with the detriment going primarily to the manufacturers?

Mr. **Bergsten**. It is broader than that, I think. There are benefits to the financial community, although, as the city of London learned, the financial communities in big monetary centers can prosper even if their national currency is not the center of the action.

For many years the British thought that if sterling's international role was to decline, the city of London would diminish as a financial center. To the contrary, when the dollar replaced sterling as the world's main currency, the Eurodollar market got going in London and the city did better than ever before. So there is a bit of a fallacy there, and I would not put too much weight on the benefit to the financial institutions, though certainly there is some.

The big beneficiaries, actually, of an overvalued dollar are importers and consumers of imported goods, because the overvalued dollar means that imports are cheaper than they should be in some underlying equilibrium sense. Our dollar buys more deutschmarks with which we can buy German cars or VTR's or whatever.

Tourists traveling abroad see their dollars go a lot further now in Paris or Tokyo or Mexico City than in the past. So it is importers of goods or services who benefit very substantially.

The other side of that coin, of course, is import-competing industries. Our own auto industry, steel industry, electronics industry are disadvantaged because the imports are cheaper and, therefore, more attractive.

In broad economic terms, I would say the main beneficiaries of an overvalued currency, overvalued in trade terms, would be importers. Not so incidentally, it does help to hold down the overall inflation rate. It has been estimated that our inflation level at the end of this year will be 3 or 4 percentage points lower than it would have been absent the strengthening of the dollar over the last couple of years.

So one can view an overvalued dollar as a component of an anti-inflationary strategy. Particularly back in 1981 and even early 1982 one might have said OK, it is desirable on those grounds—it causes some pain, but helps us to wring inflation out of the system. I do not take that view because I think an overvalued dollar in this sense is inherently a transitory phenomenon. It has to be corrected, and always has been corrected in the past, because it is unsustainable to maintain that degree of lack of competitive pricing. Therefore, inflation gains from it are transitory and may have even misled you into thinking that your inflation battle has gone better than it has.

As I indicated, the inflation rate is substantially lower than it would be because the dollar is overvalued. We should not be misled, in short, into thinking that the underlying U.S. inflation rate is down to 2 or 3 percent. It is more like 5 or 6 percent for a variety of reasons, but partly because we cannot count on the dollar staying overvalued forever. And so I would not put great weight on that factor as a beneficial one.

But some people do, and in broad terms there is, at least in the short run, significant anti-inflation effect from an overvalued currency of the type we have had.

Mr. **Jenkins**. You think there are 2 or 3 percentage points of inflation built into that overvalued dollar now?

Mr. **Bergsten**. Yes. The rule of thumb is that for every 10 percentage point move of the dollar against the basket of other currencies, our Consumer Price Index moves about 1½ percentage points in the opposite direction. So right now, with the dollar overvalued at least by 15 to 20 percent—it has come off a little bit since November, but is still overvalued by, say, 20 percent—a correction would add something like 3 percentage points to the inflation rate. Likewise, if it has been strengthened that much over the last several years, it probably took something like 3 percentage points off the inflation rate—not all in 1 year, but reducing the level by that much.

So yes, there is a significant impact. We have seen it on the downside back in 1978. We have seen it on the up side the last couple of years. I am afraid we will see it on the down side again.

Mr. **Jenkins**. Thank you. Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Schulze?

Mr. **Schulze**. Thank you, Mr. Chairman. Fred, thank you for your testimony. You have mentioned that we have got to get the deficits in line. I think realistically, we have two choices; to increase taxes or decrease spending. I believe realistically, we are not going to decrease spending. From a political standpoint, it is relatively doubtful.

So that leaves us one option; to increase taxes and, of course, the business community would bear the brunt of that. It would put them in a further noncompetitive position. So what is your suggestion on how we get out of this dilemma?

Mr. **Bergsten**. My suggestion is to go back and review your initial premise that there is no possibility politically of cutting expenditures. I think the Congress has to find ways to cut expenditures if we are going to have a viable, longrun development of this economy. Certainly, some tax increases have to be part of the package, but my own judgment would be you have to search for a balanced package which does include some slowing in the defense buildup, some further cuts in domestic expenditures and some increases in taxes.

I would commend to you the package of proposals put forward in that vein by the so-called bipartisan budget appeal led by five former Secretaries of the Treasury and Mr. Peter Peterson, former Secretary of Commerce which, over the last couple of months, has laid out and publicized widely a package aimed at bringing the fiscal year 1985 or 1986 budget deficit down well under $100 billion.

Everybody recognizes that it would be tough, and there are political constraints of the type you mentioned. On the other hand, I feel if the Congress and the administration do not do it, that the effects will also be catastrophic. High interest rates will continue.

We have the spectre right now at the very beginning of an economic recovery in this country of pressures on interest rates to start rising again. That to me is catastrophic. Real interest rates remained at stratospheric levels in the second half of last year when this economy was dead in the water.

Now, at the first sign of recovery in mid-January and, again, in the last few days, we have pressures on interest rates to start moving back up again from levels which in historical terms are already at record real levels. Why is that? There are a lot of reasons and different schools of thought, but clearly one reason is the spectre of those huge outyear budget deficits hanging over the economy as a whole. If you do not get those down, I do not think you are going to get much of a recovery.

It is true that if there is a big decline in the world oil price, that will give us a stimulus for a time, and in fact, that is the first major note of optimism that I have seen coming into the picture in the last few months. But even so, unless there is a substantial attack on these longrun deficits in the Federal budget, I do not see how interest rates are going to come off sustainably. I do not see how the dollar is going to correct and, therefore, improve our international position.

I am afraid I would recommend that you go back to that premise and try it again.

Mr. SCHULZE. So realistically, you believe that there is an opportunity for cutting entitlements and some of the other spending along with defense?

Mr. BERGSTEN. I always have confidence in the American political process. Things always look gloomy in the short run and it looks impossible to do what we need to do, but over time, dramatic changes are made and work out. Who would have ever thought we could have cut our oil imports in half in 5 years, reduced our dependence on OPEC, seen a basic change in that situation?

The Congress took some actions, two Presidents took actions, and there has been a major change in a situation that, 5 years ago, many people thought was irreparable.

We can change, but it takes a good deal of leadership; the same issue the chairman raised about the trading system. I do not see it right now, frankly, but I am confident that even if things get worse before they get better we will do it because we have to. I just do not think the country can go on viably with that kind of budget and economic outlook.

Mr. SCHULZE. How much effect will petroleum have alone on the imbalance and the overvaluation?

Mr. BERGSTEN. It is a tricky question. My answer is based primarily on the history of the last 10 years. Both times that the oil price went up sharply, there was a very substantial strengthening of the dollar and a weakening of the yen, the deutschmark, and some other currencies.

Two basic reasons have generally been adduced to explain that. One is that the United States was much less dependent on imported oil than other countries. Therefore, they were hurt worse and their currencies were written down and ours was written up.

Second, the financial effects. When the oil price increased, money was taken out of the pockets of consumers of energy in Japan, Germany, Brazil, et cetera, as well as the United States, and shifted into the coffers of the Saudi Arabia Monetary Agency and other central banks of big oil exporting countries. Since those big oil exporting monetary authorities tend to hold the great bulk of their reserves in dollars, what you got was a net shift out of yen, deutschmark, cruzeiros, et cetera, into dollars. That strengthened the dollar in the exchange market. So there was both a trade effect and a financial effect that strengthened the dollar when oil prices went up.

Now, we do not know if the world is wholly symmetrical. But even if it is partly symmetrical, there ought to be a somewhat opposite effect as the oil price goes down, particularly if it goes down significantly. Therefore, one would expect to see a fairly substantial correction in the currency alinements. Fortunately, this time it would go in the direction needed for the reasons we are talking about.

Add to that likely decline in the oil price the fact that our trade has already moved into record deficit, and looks like soaring further this year. Martin Feldstein's estimate is that the merchandise deficit will be $75 billion. That would be two and a half times the previous record. I am afraid it could even go higher at annual rates toward the end of the year. At any rate, it will be a big increase.

The Japanese surplus is again rising, as is the German surplus. So, on the underlying economics of it, there ought to be a rather substantial correction. I have argued that the dollar is now overvalued on the order of 20 percent against an average of other currencies. I think after the yen moved in November to January, that 20-percent number is probably also about right for Japan. So a correction of that type is what is needed.

However, I would have to again say there are caveats. The safe haven factor we talked about a moment ago could perpetuate excessive strength for the dollar, excessive in terms of underlying economic relationships. If interest rates started to bounce back up here, that would hurt. Again, if the oil price comes off significantly, that by itself will help pull interest rates down. It will lower inflation, therefore inflation expectations. It will give a little more room to maneuver for monetary policy.

So I think interest rates ought to come down if the oil price comes down.

The other point to keep in mind is that when big currency movements occur, they sometimes—in fact, usually under flexible rates—go further than you want. We had the dollar getting too weak in 1978, too strong lately. It could overshoot again on the down side.

So, in answer to your question of how much, it could go more than the 20 or 25 percent needed as bandwagon effects begin to roll in a negative direction and take the dollar down.

Mr. **Schulze**. Are you willing to make a guess as to where you think it will go?

Mr. **Bergsten**. Well, you have to do that pretty much in terms of individual currencies.

Mr. **Schulze**. With Japan.

Mr. **Bergsten**. With Japan, I would think there is a strong possibility that we could see a yen at 200 to the dollar within the next 6 months. I think that is a very strong possibility. That would be enormously beneficial. I think it is very possible, particularly if we do get a substantial decline in the oil price, which I also think is on the whole a probability.

Mr. **Schulze**. Are there further steps the Japanese Government could or should take along this line?

Mr. **Bergsten**. There are a couple of things I would mention. If the yen again begins to strengthen in the exchange markets, as I think it will, then I would support some central bank intervention in the exchange market to push it along. Intervention cannot, I think, change the basic underlying trend of exchange rates, but we do know that it can affect the pace and extent of movements.

As I said before, a golden opportunity was missed in December and January when the yen was strengthening. I think some judicious statements, plus some coordinated intervention, preferably between the Japanese and United States central banks, could have built on the market trend and pushed the process further and we could have a yen that is much stronger today, therefore obviating some of our problems. That is one step.

A second step: If the other factors we are talking about—the oil price, U.S. action on interest rates, et cetera—do not suffice to get the yen strengthened as it needs to be for trade reasons, then I would repeat a suggestion that I have made earlier before the committee. I think the Japanese could themselves strengthen the yen by cooling the degree of capital outflow.

One of the underlying reasons for the yen weakness in my judgment is the fact that when Japan liberalized its capital markets about 2 years ago, the effect was a huge outflow of capital.

For 30 years, Japan had enjoyed enormous economic growth, which meant a big buildup of wealth in Japan and, of course, a very high savings ratio, meaning a lot of that wealth was in fact saved. But all through that 30-year period, Japanese investors had very little access to foreign securities to put their money abroad. So there was an enormous pent-up demand for foreign investment, as would naturally be the case. Anybody wants to diversify his portfolio to some extent.

Then, when the capital controls were liberalized in late 1980, that pent-up demand suddenly had access for the first time to trillions of dollars worth of dollar assets, sterling assets, Euro assets all around the world, and a classic portfolio adjustment took place—a big rush of money out to take advantage of that access to foreign securities which, of course, meant downward pressure on the yen and a weaker exchange rate.

Now, to be sure, they also liberalized on the inflow side and there was a big increase in inflow of capital. But because their capital market had also been insulated for those 30 years, it was not as attractive to outsiders as the foreign markets were to the Japanese. So there was a big increase in capital flows on both sides of the account, but net a big capital outflow, pushed along by the interest rate differentials.

I therefore think that it would not be amiss, if needed to deal with the exchange rate problem, for Japan to essentially smooth out over a longer period of time the capital outflow stemming from its liberalization. Then liberalization is a thoroughly good thing. It was urged on them by the United States and others. It is important over the long run to get it, but its shortrun effect has been to contribute to this weaker yen and therefore create trade problems.

So, if needed, I would still think some administrative guidance that led to limitation on capital outflow by big Japanese insurance companies, banks, other institutional investors would suffice to reduce the demand for dollars in the exchange markets against the yen and help rectify the exchange rate imbalance.

Mr. Schulze. Thank you.

Thank you, Mr. Chairman.

Mr. Gibbons. Thank you.

Mr. Hance?

Mr. Hance. Mr. Bergsten, I appreciate your being here. Were you here when Congressman Stark testified?

Mr. Bergsten. Yes, I was.

Mr. Hance. Would you comment on his testimony and the proposed legislation that he mentioned?

Mr. Bergsten. I had a very positive reaction to his first bill, the one that would propose a reduction in tariffs in the semiconductor sector in this country vis-a-vis other countries that took similar action.

I think that is in fact, as I suggested in my statement, the right way to go. It offers a carrot, an incentive to other countries to reduce their barriers to our industries. It does it in an industry where we are highly competitive, and therefore, I think, can afford to liberalize ourselves as part of a deal of that type.

His second bill, I must admit, raises major questions in my mind. Though I would want to study it carefully before taking a final position, my immediate reactions were quite skeptical on two counts. There are a number of administrative problems with any assignment of allowable deficits, and I think Congressman Frenzel himself immediately pointed to a number of those.

At the broader level of policy, I think the approach would be an enormously dangerous precedent. Both Mr. Frenzel and Mr. Stark himself made the point that if we allowed Japan to run only, say, a $10 billion surplus with us, the Europeans might equally then conclude it was legitimate to allow the United States to run only a $5 billion surplus with them, or some arbitrary number, and we would not like that. Indeed, I think we would probably roll out the 6th Fleet if anybody tried to do that against us.

The argument is that Japan is unique, so it would be OK to do it against them but not against us. As I indicated in my statement, Japan does operate differently but the jury is out on whether the difference in Japanese institutions and practices really have a big impact on trade and economic relationships.

I would, myself, counsel the more cautious, though deliberate, approach that I mentioned in my own statement, going in a rifleshot way at specific industries where we could demonstrate to our own satisfaction and other peoples' that Japanese practices were hurting us, and then hit them, but hit them very specifically on those practices in specific industries where we could see it.

I think a blunderbus, across-the-board approach which amounted to, as he said, a 50-percent import surcharge on anything above an allowed level simply would be the wrong way to go.

Mr. HANCE. I can certainly understand the administrative problems, because you do not know on a day to day basis what your trade deficit might be. But in some ways it seems to be a pretty good idea, because in effect it does not tell them exactly what they can and cannot do, but just sets some guidelines and lets them make their internal decisions.

I appreciate your being here.

Thank you, Mr. Chairman.

Mr. GIBBONS. Mr. Russo.

Mr. RUSSO. Thank you, Mr. Chairman.

Mr. Bergsten, what would you say is the greatest problem that the United States faces from Japan? Is it their tariff and nontariff barriers, or is it the weakening of the yen?

Mr. BERGSTEN. I think clearly the exchange rate misalinement is the biggest problem. As I indicated in my statement, I think tariff, and at least traditional nontariff barriers are really not much of a problem. But I would add as the second most important and perhaps longer run and more structural question the issue of Japanese industrial policy and targeting of particular industries, which I think we have to address very forcefully on a sector-by-sector basis.

Mr. RUSSO. Is it not a fact that their testing and inspection procedures make it very difficult and actually discourage a lot of our business from exporting to Japan? So when you say the nontariff barriers are really not that important, do you not believe that our accessibility to their marketplace is really restricted in those industries that they want to protect?

Mr. BERGSTEN. It may be that we have only a semantic difference. My argument is that in the area you mentioned, testing and other access devices, the issue is not one across the board, but rather, as you suggested, one which may affect particular strategic industries. My response is that instead of attacking that problem in an aggregate sense, I would attack it within the context of concerns about Japanese industrial policy and particular sectors about which we have concern.

When I go to the bottom line and look at U.S. exports to Japan and U.S. penetration of the Japanese market, I do not come away with a gloomy picture. As I mentioned, U.S. exports of manufactured goods to Japan are much higher than our exports to Germany. Germany is a bigger importer in toto. It is regarded as a free market. Yet, we do a lot better in Japan than we do in Germany.

There was recently a major study published by a number of groups, including the American Chamber of Commerce in Japan, some other American and Japanese groups working together, which was publicized a couple of weeks ago in the Wall Street Journal. It made a very strong case that American penetration of the Japanese market was extensive. As I recall, they said there were only 7 percent of all the sectors of Japanese manufacturing in which there was not a significant American presence.

So, yes, there are problems in particular industries, no doubt about it, but I find it hard to see that there is a problem across the board in terms of market access.

Mr. RUSSO. I guess if you spoke to the steel workers and auto workers in my area, you would have a difficult time convincing them that there is not such a tremendous problem regarding trading with the Japanese. They are out of work. They are unemployed. There is basically no future for them. We need to deal with that political question.

Do you have any solution for our auto and steel industry?

Mr. BERGSTEN. I could not agree with you more that we have to deal with it, and I certainly would not say there is not a trade problem with Japan. I would not try to tell your constituents that, nor would I try to tell you that.

What I have tried to do is zero in on what is the nature of that problem, and where can we do something about it. Certainly, the exchange rate changes, though seemingly esoteric to your auto worker and steel worker constituents, would help them enormously.

Mr. RUSSO. The liberalization of the capital markets, was that done to weaken the yen so that imports in other countries would be better?

Mr. BERGSTEN. I do not think so. I dearly wish in retrospect, as I did at the time, that they had liberalized their capital markets much earlier. If they had done it at a time when the yen had been strong, and needed to come off a little, then the timing would have worked out much better. I think frankly it is an unfortunate coincidence of timing. The measure was urged on them by the United States, and practically all other countries around the world for many years. They delayed, and did not do it as soon as they should.

The timing turned out to be very unfortunate, but I do not think it was a devious effort to provide an undervalued yen. In fact, many people think that over time the liberalization of the capital market will strengthen the yen by producing more capital inflow.

One of the problems when we deal with the Japanese is that it takes them so long to do anything. They say a lot of things, that they are going to move on a lot of things, just like in the telecommunications area where we are waiting over 2 years now, and they have not really done a lot in opening up government procurement to our firms.

One of the frustrations we deal with is something that Pete Stark raised. We want you to have access to our markets. All we want is the same kind of access.

Mr. RUSSO. One last question, Mr. Chairman. When you talk about the long-term problem that our economy faces in dealing with the new changes in the world economy, where do you see the challenges to our economy in the future? Who are our future Japans? Who are we going to have to compete with on such a major scale, and which of our industries do you think are going to be affected?

Mr. BERGSTEN. I think the growing competition of most concern is in these high-technology sectors that have come front and center in the relationship with Japan. They will increasingly show up in our relationship with some Europeans, but even more so, with the newly industrializing countries, the so-called little Japans in the Far East, where we have already seen intense competition in television sets, semiconductors, and some other electronic areas—Korea, Taiwan, Singapore, Hong Kong, and the like.

Once they get past their current debt crises, some of the Latin American countries—particularly Brazil but a few others as well—may also turn out to be sharp competitors in this high technology area.

That is probably where we are going to see increasingly a very severe challenge to the American economy, which has security as well as economic connotations, and we will have to devise a very sophisticated strategy to respond.

Mr. Russo. Are we working on it?

Mr. Bergsten. As I mentioned in my statement, there are some embryonic steps. The administration did set up a high tech committee to start talking about this with the Japanese, but as I indicated, there has been a lag. There has been too much effort to deal with the problems of the past—specific, very narrow problems such as beef, citrus, baseball bats.

You have to deal with those, but they should not be at the top of your priority list because that is not the cutting edge of our economy or the world economy, and you have to get on with the higher technology sectors that are going to determine who succeeds in the world economy in the future.

Mr. Russo. Thank you.

Thank you, Mr. Chairman.

Mr. Gibbons. Mr. Pease?

Mr. Pease. Thank you, Mr. Chairman.

Mr. Bergsten, I appreciate your testimony. I think it was excellent and very, very helpful.

Would you contrast measurements of private savings in the United States and Japan with the budget deficits in both countries, and comment on how this affects the ability of either country to compete in overseas markets?

Mr. Bergsten. Certainly. Private savings levels are enormously higher in Japan than in the United States, roughly three times as high. The causes for that are, I think, fairly well known. It goes, again, to some of these institutional differences that I alluded to before.

The savings rates in Japan are much higher. One thing that means is that Japan can afford to run much bigger government budget deficits than we can, because they can finance them out of savings and not have to monetize the debt.

Indeed, as one looks at what ought to be done to revive the world economy now, my Institute pulled together a meeting in December of 26 top economists from around the world, including two top Japanese economists, and tried to lay out a global recovery strategy. Part of that strategy suggested that Japan ought to take more stimulative domestic economic policy measures, primarily through fiscal expansion.

That runs counter to a very widespread urge within Japan to reduce their budget deficits, which, in absolute terms are high, but compared to their national savings, and when taking into account the cyclical element of those budget deficits, are not all that high. Therefore we felt, and this included two of the very top private economists in Japan—one of them used to be their minister of foreign affairs—that they could do it and should do it.

So there is a greater scope in Japan for fiscal expansion in the macroeconomic context.

Another implication of what you say is that, with high savings levels, Japan needs high rates of domestic investment to use up those savings, or else there will be a tendency for sharp capital outflow which will weaken the yen and create a surplus in their current account.

That is the other side of the point that Martin Feldstein has been making repeatedly here, that as long as we run huge budget deficits. It is the other side. We have low savings and high account deficits. It is the other side. We have low savings and high budget deficits. They now have high savings and relatively low budget deficits, but also low levels of domestic investment.

As long as Japan was experiencing economic growth of 10 percent a year, investment was moving ahead and soaking up those domestic savings, and in fact even importing capital. So you can either refer to it as an excess of savings at those high savings rates, or an inadequacy of investment.

I would prefer that their investment level come up to soak up their savings, but one way or the other, they have got to reach a better balance, or else it distorts on the international side as well as within their domestic economy.

Mr. **Pease**. Thank you.

An intriguing thought just occurred to me. Mr. Schulze referred earlier to the political difficulty of bringing down the deficit over the next few years. Would your statement about the situation in Japan suggest that it would be easier for us to vastly expand our savings rate in the United States rather than cut down the deficits, perhaps by eliminating Federal income tax on interest?

Mr. **Bergsten**. Well, I will not comment on specific techniques, but certainly it is desirable to get up our savings rate for a lot of reasons. The one you mention is perhaps not at the top of my list, to finance big budget deficits in the Federal Government, but I would like to see a much higher savings rate.

The administration's basic economic policy has been aimed to try to do that. I never had much confidence that they would, but objectively, one has to admit that in the midst of a recession and flat demand, you really cannot tell what the results will be yet. Certainly we ought to try to get our savings rate up. That would help, among other things, to moderate the level of interest rates in this country, and over time, I think, some movement in that direction may turn out to be an essential part of a viable economic strategy for this country.

Mr. **Pease**. Thank you.

Could you comment for me, please, on the auto industry in Japan and the United States? That is a broad question, but the Japanese auto industry is still creating fits for our industry. We still are not selling cars in any meaningful quantity in Japan.

There is currently a voluntary restraint on the part of the Japanese which has been extended for one more year.

The auto industry is a major source of trade between our two countries. What lies in the future for the auto industry regarding trade between Japan and the United States?

Mr. **Bergsten**. There are well known transitional problems that our own auto industry faced, and perhaps reacted to rather slowly. When energy prices went up, demand for more fuel efficient and smaller cars came along. The Japanese were ready to fill that gap. Detroit was not. So there was an enormous expansion in the Japanese market share in this country.

Once having gotten that market share, they seem to have acquired quite a lot of buyer loyalty, and therefore it is probably not possible to put the genie back in the bottle in any complete sense.

I have felt that our own auto industry was moving in the right direction to respond to the competitive challenge. They have made sizeable investments in plant and equipment. The auto workers have accepted some moderation in wages, which certainly has been a part of the competitive problem. So there have been domestic steps taken by our industry that at least move in the right direction.

At the same time, the auto industry is one where this currency imbalance plays a major role. Note that what we have done over the last couple of years has greatly strengthened the Japanese auto industry.

First, we have induced them to accept a quantitative limit on their volume of sales to the United States, so they have had no inducement to reduce prices. They have had basically a given quantity of sales, and I think they came in one car short of it last year. They met it, despite a declining market. So they could meet their quota without reducing prices. Of course, they upgraded the quality of the cars they sold so as to get more value added and more value for a given volume.

At the same time, with the exchange rate imbalance where it was, their dollar earnings from that given volume of sales translated into an enormous yen return. If you look around the world's industrial structure for the last couple of years, Toyota and Nissan have had among the highest profits of any companies in the world relative to their traditional outcome.

So, a combination of our policies have enormously strengthened the competitive capability of the Japanese auto industry. Now, that is an anti-industrial policy, if you want to put it that way, for our own country, and demonstrates how by ad hoc responses to these issues and dealing with the exigencies of the moment, we probably make the longrun situation worse.

I would also submit for your consideration a study I became aware of in the last couple of days. I gave two seminars at Harvard on Tuesday along the same lines we are talking about today on United States-Japan relations, and I was given a study that a group at the Harvard Business School had just produced called, "The Wreck of the Japanese Auto Industry," which argues that the whole success of Japan's automobile sector was predicated on the very rapid growth of demand for autos over the last 10 years or so, first within Japan itself and then within the world market. The compliance of labor, the full support of supplying industries, the whole panoply of practices that made the Japanese auto industry so competitive was wholly reliant on a rapid growth rate. When that growth rate declines, the whole package may, in fact, wither very sharply. They go so far as to call it "The Wreck of the Japanese Auto Industry."

They note, rightly, that auto demand in Japan has now become satiated; that the U.S. market, even without the controls, is not going to grow as fast as it did in the past but with the controls, that puts a limit on Japanese sales here and most other countries have put on controls. So the Japanese auto industry now has no scope for very much growth, let alone the double-digit growth rate that it experienced through most of the last decade or so.

They argue, on the basis of that fundamental change in the demand picture, that the Japanese auto sector will suffer major competitive deterioration.

I would commend that to you. I am not enough of an expert on that industry myself to be able to judge it. I thought it was a fascinating thesis, and if so, it may offer some prospect for an approved competitive relation on our part.

Mr. PEASE. Thank you. I quite agree that the overvaluation of the dollar has been a major problem with selling American automobiles overseas. I am not as confident as you that the undervaluation of the yen will straighten itself out. I am a little concerned that the safe haven aspect may build in a permanent overvaluation of the dollar. Maybe not 20 percent, but a permanent disadvantage for U.S. trade.

I am wondering—if that is the case—how do we go about dealing with that? Do we need to abandon our devotion to the flexible exchange rate?

Mr. BERGSTEN. You may well be right. I would ruefully admit having been premature over the last year or so in expecting a correction in both the dollar and the yen exchange rates. Safe haven and other factors have kept that from happening, much beyond what I and some other analysts would have thought.

I would also note that the dollar was substantially overvalued for at least a decade, maybe more, through the 1960's and into the early 1970's under, of course, the old fixed-rate system of Bretton Woods. Despite continued deficits in our balance of payments position as then measured, the dollar actually appreciated on balance during the decade of the 1960's and was in a worse competitive position in 1970 than it was in 1960, despite all the alarms. So then had to come the two big devaluations and our position was put right.

I make that point partly to say that there is something of a correlation between the degree of international tension and the dollar exchange rate. All through the fifties and sixties, the period of the cold war, the dollar was overvalued. In the 1970's, a period of détente, the dollar was at more equilibrium levels and even somewhat undervalued. That is a highly simplistic correlation, but many people do not notice it, and I think it is worth keeping in mind.

Now we are back to a period of greater tensions, both East-West, economic, the whole array of factors, so I would not rule out what you say. If that were to occur, it would then be devilishly difficult to deal with it.

I have, myself, argued for moving away from unfettered flexible exchange rates, and total nonintervention toward a system of what I call target zones where the major countries would be continually trying to monitor the proper underlying relationships among currencies in terms of their economic competitiveness and take steps to keep rates within those ranges.

But if there are market pressures that are always pushing the dollar, say, to be above that range for safe haven reasons, then whether its fixed rates or flexible rates or anything else it is going to be terribly difficult to avoid an overvaluation in terms of competitive relationships.

That, then, faces us with the question, do we want to sit back and enjoy it, because there are benefits. It holds down prices, cheapens imports, cheapens foreign travel, gives us financial rents from the big financial role. Or do we reject it because of the effect on our import-competing industries like your autos and steel and our export? And then, what to do about it?

You could do things, certainly, in terms of affecting capital flows. You could even affect trade flows, though I think that is more likely to be counterproductive. It basically does come back in that case, I think, to your macroeconomic policy, your level of interest rates and fiscal positions relative to the rest of the world.

But if we feared that was going to happen, then the kind of concerns that Marty Feldstein has been expressing in the short-term situation would become a much more structural problem and raise even greater needs to get down the budget deficit, hold real interest rates to lower levels so that we could offset, in essence, the safe haven virtue with a lower level of interest rates than the rest of the world.

That, in fact, was the U.S. situation through most of the earlier postwar period that now has been reversed and that is, along with the safe haven, a major reason why the dollar has been so strong for the last couple of years.

Mr. PEASE. Let me ask one final question, because I know there are other witnesses. The Japanese, according to the newspapers recently, apparently are targeting—despite your best advice—the aircraft industry for future growth and expansion. Inasmuch as the United States has such a dominant role in the aircraft industry, when the Japanese choose to target that area doesn't that amount to a provocative act against the United States?

Mr. BERGSTEN. Again, I think it is a little more complicated. Japanese and other foreign observers would note that an important part of the ascendance to world dominance of the U.S. aircraft industry goes back to U.S. Government support for the industry for particularly, military objectives, the early stages of the 707 and 747 both having been heavily involved in military considerations.

It is, I think, unassailable that a good deal of U.S. Government money, research support, market assurance in terms of a purchaser for initial runs, did come from the Government. So another country seeking to get into the act could, in fact, take almost an opposite view to what you said. They could argue that the United States built up a dominant global position through unfair practices. It had all this Government support, it developed an industry with the massive resources of the Federal Government in the United States to a position where now we are left out in a high-technology industry.

I would not like to accept that either, but I would want to understand that as backdrop for assailing any other government's policies.

I would come back to the principle mentioned at the outset. Infant industry protection ought not to be permitted for mature industrial economies. That does, in some sense, say let bygones be bygones, and it is easy for an American to say because it really says forget what we did 20 years ago to get ours going; you cannot do it now.

I guess at the end of the day I would take that line, because I do not see any other principle that can guide a response to the problem that you mentioned other than that one. So I would go after them, but I am not sure I would do it without at least recognizing that there has been some similarity in the history of developing my own economy.

Mr. **Russo**. Would the gentleman yield for comment?

Mr. **Pease**. Surely.

Mr. **Russo**. What I find interesting is that as a government, we are encouraging Japan to expand their defense effort. In doing so, isn't one of the consequences of that expansion going to be to get them into the aerospace industry and, therefore, compete with our own aerospace industry and, that this might have the same effect on our aerospace industry that it has had on steel and automobiles?

Mr. **Bergsten**. It certainly might. There are particular industries—obviously, defense-related industries—where a buildup in Japan's defense capabilities certainly would help their competitiveness.

The "Economist" ran an article a couple of years ago which said the only sector in which Japan has not really engaged in world competition in the postwar period is the military sector. The Economist argued that was a bad thing. They thought that to get Japan in would help hold down military overruns, enable us to reduce our own Defense Department costs, et cetera. But in terms of competition it would be what you said.

However, there is one other aspect that has to be mentioned. Suppose Japan did, say, double the share of its GNP that went into defense from 1 to 2 percentage points. Would that, on balance, help or hurt the Japanese economy in its competitiveness? We tend to think that, on balance, our relatively big defense component of GNP hurts our competitiveness; that we are spending a lot of money in relatively nonproductive sectors, and that the lower Japanese GNP share going to defense has helped their competitiveness.

If that is true, then if they were to double or triple their share, you would have to believe it may hurt them because now they are diverting resources away from supporting their next generation's computers over to paying for troops and boats.

Mr. **Russo**. I gather they would not have the cost overruns that we have in our Pentagon. That is the difference.

Mr. **Bergsten**. They might be able to get the best of both worlds, but I do think you have to keep that in mind. What will be the aggregate effect of a shift? I know some American economic strategists over the years have felt that one way to help U.S. economic competition with Japan would be to get Japan to up its defense expenditures. So again, that one has both sides of the coin.

Mr. **Pease**. If I can reclaim my time, we got a little bit off the track there. I really am deeply concerned about the Japanese decision to target the aircraft industry. We are already, as you have said, running a very, very substantial trade imbalance with the Japanese. That trade imbalance is going to grow dramatically, there are going to be severe economic and political problems as a result, and yet, in deciding which of a range of industries to target in the future, the Japanese are picking one in which the United States is the preeminent actor. This targeting can only worsen our international trade situation.

It seems to me if the Japanese were conscious at all of the relations between our countries and the problems of the future, that they would say maybe the aircraft industry is attractive, but that can only exacerbate relations between Japan and the United States. Let's pick another target area which may be slightly less attractive, but which does not impact so substantially on the United States.

Mr. **Bergsten**. This is exactly what I was suggesting, actually, in my policy proposals. In an area like this where Japan is clearly targeting and trying to improve and erode U.S. competitive positions, that ought to be at the very top of the agenda for United States-Japan trade discussions.

There ought to be principles underlying it such as I enunciated—no infant industry support, no government provision of help to an industry of that type to give it a better competitive position——

Mr. **Pease**. No domestic content requirement for aircraft sold to Japan.

Mr. **Bergsten**. That is right. I particularly do not like domestic content in a variety of industries, and this would be one of them. I agree with you.

So what you are suggesting I think would fit very comfortably within the policy framework I suggested, and really ought to be put at the top of the agenda for ongoing and urgent discussions with Japan. I agree with that.

Mr. **Pease**. Thank you very much.

Chairman **Gibbons**. But as you pointed out earlier, if we start in this discussion we are going to have to realize that people will come back to us and say hey, you did it in space when you put a man on the moon; that was targeting. Maybe we did not realize it was targeting and we did not consider it targeting at that time. And hey, you know, you have targeted everybody's aircraft industry because you have plowed so much into defense.

We have done some targeting starting with the Morell Act to Abraham Lincoln and the expansion of our agricultural industry to being the most preeminent agricultural industry in the world that still hides behind protective barriers and still exists under a 25-year-old waiver in the GATT.

You know, our agriculture sector acts as if they have a God-given right to have all the protection they have. They do not realize we had to get a special waiver and give up other things in order to get this protection for agriculture. It happened so long ago they have forgotten about it.

So, while we can look at other people's targeting, and I want to look at other people's targeting, I want to look specifically at Japanese targeting because it smacks to me of being pernicious and predatory upon our markets. I want to say to start off and to put myself in a good bargaining position, our hands are not exactly unsoiled in that area. Am I right in that?

Mr. BERGSTEN. I think you are right in that. There are devilishly difficult intertemporal problems here. Should Japan be, in some sense, permitted to do something now that we did 30 years ago, because we did it 30 years ago, or should one argue that the world has changed, Japan has changed, we have changed, and you cannot do it.

Another intertemporal problem that I alluded to briefly in my statement: Suppose modest subsidy that you put in place today has a decisive impact in getting your industry into a preeminent market position so that 10 years from now you hold 30 percent of the world market instead of 10 percent of the world market.

Under current trade law, the GATT rules and such, there is really no way to handle that. If you do not catch somebody pretty much at the time he does it, you do not have much basis to go on. When you do hit him, you pretty much hit him for the amount of that subsidy, which may be fairly small, rather than the enormous market impact it may have later.

Some of the U.S. industries that are currently seeking help in this area—and I think will be testifying to you today—make exactly that point. There are very tricky intertemporal problems here, and whether you let bygones be bygones, or keep the statute of limitations open indefinitely, is one of the very tough problems.

Mr. PEASE. Would the Chairman yield?

Chairman GIBBONS. Certainly.

Mr. PEASE. I appreciate the chairman yielding. I was going to make this point before but didn't do so out of consideration of time. Obviously, we have done some targeting, although not very consciously in the past, but in the aircraft industry in particular I think we would have to argue in return that the Japanese have been living under our defense umbrella for 40 years, and we have made major contributions to the defense of Europe for 40 years. The development of our aircraft industry and even our space industry has certainly been a result of this responsibility.

I think we might well say fine, if the Japanese want to pay one-third of the cost of the development of the B-1 bomber, or one-third of the cost of the development of the MX missile, then we will be glad to share in the civilian applications of that research. In the defense-related field we have to take into consideration that we have been, as a Nation, providing a defense umbrella for half the world for a long time. We have incurred major costs from that, and, incidentally, we have benefitted from civilian applications.

Mr. BERGSTEN. I certainly would make that argument. I think it is a legitimate argument and has to be injected into the debate.

You also put your finger on a key point, which was the sharing of the technology that may emerge from basically security-oriented efforts.

That, as I understand it, is one of the current efforts that the administration is making; to share in Japanese technological advances in a variety of the high tech industries so that there would be an opportunity for commercial spinoff to occur here as well as there.

I do not know the history well enough. I do not think we made our aircraft and missile technology available to others either on a paid basis or otherwise at earlier stages of our development. But again, times change and I think sharing of the type you mentioned, whether the research and commercial implications emerge initially in Japan or the United States or elsewhere, might be the basis for some kind of reciprocal arrangement which would then permit access to the commercial benefits on a wider basis. That may be, in fact, a key to trying to resolve the current problem.

Mr. PEASE. Thank you.

Chairman GIBBONS. Mr. Bergsten, every time you come here, you make us think harder, and we appreciate it. We may not learn all you have to teach, but it is helpful to us. I appreciate it so much.

Are there any further questions of Mr. Bergsten?

[No response.]

Chairman GIBBONS. Thank you very much.

Our next witness—we had Mr. Gephardt here but I am afraid he had to leave. Does Mr. Gephardt have a representative here?

VOICE. He should be back here fairly shortly.

Chairman GIBBONS. Fine. From Motorola, Mr. Stephen Levy who is a senior vice president of the Japanese operations of Motorola.

I will say to you I have been looking at all of your ads. Unfortunately, I have not had a chance to read them all. I know you have had quite a campaign going.

STATEMENT OF STEPHEN L. LEVY, SENIOR VICE PRESIDENT FOR JAPANESE OPERATIONS, MOTOROLA, INC.

Mr. LEVY. I think you might find the last two slightly different.

Chairman GIBBONS. Fine. If I miss them, would you happen to send them to me, please?

Mr. LEVY. I certainly will.

Chairman GIBBONS. Thank you, sir, and you may proceed as you wish.

Mr. LEVY. Mr. Chairman, and distinguished members of the Trade Subcommittee, it is a pleasure to appear before you today to present Motorola's views on the United States-Japanese trade relations.

We know that this subcommittee has devoted considerable time and attention to this issue in the past, and as is evident by this hearing and your proposed trip later this month, the subcommittee plans to continue to do so.

Such extensive efforts are clearly warranted by the importance of Japan to U.S. interests in the Pacific region, and the growing significance of trade issues to that broader relationship.

Motorola happens to share the subcommittee's strong interest in United States-Japanese trade relations. For a company like Motorola, which competes in a broad range of advance electronics markets, Japan represents an unprecedented challenge; one which has had a fundamental impact on our business. This challenge stems from both the strong competence of our Japanese competitors, and fundamental differences in the United States and Japanese economic systems. We regard the first part of this challenge as solely our responsibility to meet, and we believe that we are doing so by a variety of means.

Our corporation has sought to compete vigorously in world markets and we now derive more than one-third of our revenues overseas. As you know, we have made a special effort to participate in the Japanese market, including selling to NTT and acquiring semiconductor manufacturing facilities in Japan.

Through these and other means, Motorola believes it is capable of competing successfully with any firm operating by the same rules of the game that we operate by in this country. We also believe that the rules Japan has employed to achieve national objectives in certain targeted industries give important market-distorting advantages to our Japanese competitors, and that those advantages cannot be overcome solely by the efforts of most individual companies in this country.

Just as Japan's Government has acted to shape the rules to favor certain industries and firms, we think that the U.S. Government must now act to assure that the market-distorting advantages created are not permitted to further distort international competition. The problem of Japan's industrial targeting policies is certainly a familiar one for members of this subcommittee. I will not try to cover here today the various forms such policies take, because they have been well documented by others.

I would like to discuss the effect of such policies on American companies. It seems to me that there are both some obvious effects which can be reasonably measured and some much more subtle effects. The obvious effects include loss of market share, jobs and profitability. These effects occur after a targeting policy is successful in altering conditions of international competition.

The SIA study very accurately describes such effects in the case of dynamic memory, a product of critical importance to the future of U.S. semiconductor and computer industry. It shows that the substantial erosion of U.S. market share and the substantial business losses recorded in the last 2 years can be directly related to Japan's targeting efforts.

In addition to these evident effects, targeting has a much more insidious and, in the long run, more dangerous effect. In essence, it lessens the risks for Japanese firms and, hence, increases risks for U.S. firms in the same business, and even in related businesses. This shifting of risk alters the decisions of U.S. firms with respect to both investments and R&D. In high tech businesses like ours maintaining high levels of investment, and R&D expenditures are critical to our future competitiveness.

By increasing the risks for U.S. firms in targeted industries, Japan discourages these U.S. firms from spending what they need to spend to remain competitive and encourages them to shift their business structures accordingly.

The SIA study suggests the kind of adjustment that can occur in a very short period of time. From 12 U.S. companies producing 16K RAM's, we have dropped to only 3 companies in volume production of 64K RAM's. Six Japanese companies were in both generations of RAM's. The juxtaposition of a sharp drop in the number of U.S. firms and the same number of Japanese firms in successive generations of RAM's indicates how the shifting of risk caused by Japan's targeting policy can alter patterns of competition.

But the effects stretch even further in the advanced electronics sector. Because of the sophistication of the components and products involved, there must be a very close working relationship between supplier and customer. If that kind of relationship does not exist, the customer may not gain early access to or be able to exploit fully newly developed components. Thus, the loss of U.S. dynamic memory industry can undermine the competitiveness of the U.S. computer industry.

The Japanese have recognized this interaction in their industrial policy by first stressing semiconductors and now shifting their attention increasingly to computers. We will not have solve the problem of targeting until the U.S. environment can be created that shifts the risk back to those doing the targeting.

I would now like to comment on the four other issues highlighted in the hearing announcement. First, on the openness of the Japanese market. Access to the Japanese market is an important issue for us, but not nearly as consequential as the impact of the Japan's targeting policies outside of Japan. Clearly, there has been some progress achieved in opening the Japanese market to competitive U.S. products, but in our line of business, the effects in terms of additional business generated are not large.

Given the inertia of the Japanese system against imports, particularly for nonconsumer products, reduction of explicit barriers is not sufficient to bring about real change. Even for companies that aggressively pursue the opportunities created by Japan's import liberalization actions, progress comes only slowly and at considerable costs.

Significant increases in the Japanese market will only be achieved if Japan acts affirmatively to overcome such inertia, which is a residual effect of many years of protection and Government intervention. Frankly, the U.S. Government's preoccupation with access to the Japanese market and the series of Japanese packages that resulted have created in our view unrealistic expectations about results.

Even in products where the United States has a competitive advantage, results will be slow in coming. Meanwhile, inadequate attention has been directed to Japan's industrial policies and their effects on dynamic comparative advantage. Ultimately, it is this issue that will determine how well our two fundamentally different economic systems will coexist.

Now, with respect to NTT, Motorola has made very substantial efforts to sell to NTT, predating the NTT agreement with the United States by a couple of years. We are progressing well in both pagers and car telephones and hope to continue to develop the relationships with NTT in other areas as well. But it is still too early to predict the economic benefits that will accrue.

We feel that NTT has treated us fairly and have no serious complaints about the operation of the agreement. We acknowledge it has not been easy, since both sides had to go through a difficult learning experience. We recognize that many other U.S. firms are very disappointed with the results of the NTT agreement.

Clearly, the official U.S. position consistently has been that without significant NTT purchases from U.S. firms, the agreement could not be considered a success. Developments during the remainder of 1983, however, could well change this current perception among U.S. firms.

Now, as to competitive positions in high-tech trade. There is clearly an imbalance in competitive relations between the United States and Japan that disadvantages U.S. high-technology firms. For example, a U.S.-trade deficit with Japan of 20-to-1 in communications equipment is simply not consistent with what we see as the relative strengths of the U.S. industry and the Japanese industry.

A United States market share of less than 10 percent in Japan's semiconductor market is totally out of line with the majority position that the United States holds in the rest of the world. Such imbalances must be addressed and reconciled by the two governments to avoid significant worsening of relationships and to maintain a spirit of mutual cooperation necessary to the well-being of the free world.

The recently concluded U.S. High Tech Agreement may help to do that if it is properly implemented. The U.S. Government with aid and support from the private sector must aggressively utilize the opportunities provided within the framework of that agreement if it is to be successful. Motorola has actively supported the negotiation of the agreement, and we hope to play a similar role in its implementation.

The imbalance must also be addressed through U.S. policy, including U.S. trade [illegible] By asserting U.S. national interests in high-technology [illegible] negotiations with Japan may prove to be more successful.

Finally, the imbalance [illegible] to be reviewed in the context of the GATT through active [illegible] various dispute settlement procedures.

The last item deals [illegible] yen-dollar relationships. Exchange rates had been [illegible] by many of our business colleagues as a contributing factor in current United States-Japanese trade problems. Most experts seem to agree that Japan's efforts to keep interest rates low and its financial controls do have a indirect impact on exchange rates.

Absent fundamental reforms of such policies, and further reduction in U.S. interest rates, it appears that little can be done about the undervalued yen. Even if more realistic yen-dollar exchange rates are attained, we do not believe that it would have a significant impact on the risks faced by industries targeted by Japan.

Mr. Chairman, that concludes my formal remarks.

[The prepared statement follows:]

STATEMENT OF STEPHEN L. LEVY, SENIOR VICE PRESIDENT FOR JAPANESE OPERATIONS, MOTOROLA, INC.

Mr. Chairman and distinguished members of the Trade Subcommittee it is a pleasure to appear before you today to present Motorola's views on United States-Japanese trade relations. We know that this Subcommittee has devoted considerable time and attention to this issue in the past and, as is evident by this hearing and your proposed trip later this month, the Subcommittee plans to continue to do so. Such extensive efforts are clearly warranted by the importance of Japan to United States interests in the Pacific region and the growing significance of trade issues to that broader relationship.

Motorola shares the Subcommittee's strong interest in United States-Japanese trade relations. For a company like Motorola, which competes in a broad range of advanced electronics markets, Japan represents an unprecedented challenge—one which has a fundamental impact on our business. This challenge stems from both the strong competences of our Japanese competitors and fundamental differences in the United States and Japanese systems.

We regard the first part of this challenge as solely our responsibility to meet and we believe that we are doing so by a variety of means.

In 1968, Motorola introduced a Participative Management Program (PMP) designed to give our employees a more direct role in improving productivity and product quality. In many respects similar to the now popular "quality circles," PMP has proved to be a major plus for our employees and hence for our Corporation.

Motorola has consistently invested heavily in research and development and has developed a "technology roadmap" system designed to assure a long-range perspective in our R&D planning. In the last 3 years, we have spent more than $600 million on R&D, equivalent to almost 7 percent of total revenues.

Our Corporation has sought to compete vigorously in world markets and we now derive more than one-third of our revenues overseas. As you know, we have made special efforts to participate in the Japanesse market, including selling to NTT and acquiring semiconductor manufacturing facilities in Japan.

Through these and other means, Motorola believes it is capable of competing successfully with any firm operating by the same "rules of the game" that we operate by in this country. We also believe that the rules Japan has employed to achieve national objectives in certain targeted industries give important market distorting advantages to our Japanese competitors and that those advantages cannot be overcome solely by the efforts of most individual companies in this country. Just as Japan's Government has acted to shape the rules to favor certain industries and firms, we think the U.S. Government must now act to assure that the market distoring advantages created are not permitted to further distort international competition.

The problem of Japan's industrial targeting policies is certainly a familiar one for members of this Subcommittee. I will not try to cover there today the various forms such policies take, because they have been well documented by others. Recent examples include the Houdaille Petition on n/c machine tools, the Semiconductor Industry Association (SIA) study on semiconductors, and Commerce Department reports on international competition in high technology and Japanese industrial policy in computers and aircraft.

What I would like to discuss is the effect of such policies on American companies. It seems to me there are both some obvious effects which can be reasonably measured, and some much more subtle effects. The obvious effects include loss of market share, jobs, and profitability. These effects occur after a targeting policy is successful in altering conditions of international competition. The SIA study very accurately describes such effects in the case of dynamic memories, a product of critical importance to the future of the U.S. semiconductor and computer industry. It shows that the substantial erosion of United States market share and the substantial business losses recorded in the last 2 years can be directly related to Japan's targeting efforts.

In addition to these evident effects, targeting has a much more insidious and, in the long run, more dangerous effect. In essence it lessens the risks for Japanese firms and hence increases risks for United States firms in the same business and even in related businesses. This shifting of risk alters the decisions of U.S. firms with respect to both investments and R&D. In high tech businesses like ours, maintaining high levels of investment and R&D expenditures are critical to future competitiveness. By increasing the risks for U.S. firms in targeted industries, Japan discourages them from spending what they need to spend to remain competitive and encourages them to shift their business structures accordingly.

The SIA study suggests the kind of adjustments that can occur in a very short period of time. From 12 U.S. companies producing 16K RAM's, we have dropped to only three companies in volume production of 64K RAM's. Six Japanese companies were in both generations of RAM's. The juxtaposition of a sharp drop in the number of United States firms and the same number of Japanese firms in successive generations of RAM's, indicates how the shifting of risk caused by Japan's targeting policy can alter patterns of competition.

But the effects stretch even further in the advanced electronics sector. Because of the sophistication of the components and products involved, there must be a very close working relationship between suppliers and customers. If the kind of relationship does not exist, the customers may not gain early access to, or be able to exploit fully newly developed components. Thus, the loss of a U.S. dynamic memory industry can undermine the competitiveness of the computer industry. The Japanese have recognized this interaction on their industrial policy by first stressing semiconductors and now shifting their attention increasingly to computers.

We will not have solved the problem of targeting until a U.S. environment can be created that shifts the risk back to those doing the targeting. In our judgement, this will require a series of changes in U.S. policies and laws. Our Chairman, Bob Galvin, will present some ideas along this line to you next week.

In the remainder of my statement I would like to comment on the other four issues highlighted in the hearing announcement.

OPENNESS OF THE JAPANESE MARKET

Access to the Japanese market is an important issue for us, but not nearly as consequential as the impact of Japan's targeting policies outside Japan. We think the access issue has received too much attention in United States-Japanese trade relations.

Clearly, there has been some progress achieved in opening the Japanese market to competitive U.S. products, but in our line of business, the effects in terms of additional business generated are not large. Given the inertia of the Japanese system against imports, particularly for non-consumer products, reduction of explicit barriers is not sufficient to bring about real change. Even for companies that aggressively pursue the opportunities created by Japan's import liberalization actions, progress comes only slowly and at considerable cost. Significant increases in the Japanese market will only be achieved if Japan acts affirmatively to overcome such inertia, which is a residual effect of many years of protection and government intervention. In effect, Japan must apply techniques similar to those it used to develop its targeted industries to encourage imports.

With respect to Japan's three recent trade liberalization packages, I can report that there has been no appreciable impact on our operations in Japan. We did bring a complaint to the Trade Ombudsman on radio licensing, but the response has not resolved our problem.

Frankly, the U.S. Government's preoccupation with access to the Japanese market and the series of Japanese packages that resulted have created unrealistic expectations about results. Even in products where the United States has a competitive advantage, results will be slow in coming. Meanwhile, inadequate attention has been directed to Japan's industrial policies and their effects on dynamic comparative advantage. Ultimately it is this issue that will determine how well our two fundamentally different economic systems will coexist.

NTT

Motorola has made very substantial efforts to sell to NTT, predating the NTT agreement by a couple of years. We are progressing well in both pagers and car telephones and hope to continue to develop relationships with NTT in other areas as well, but it is still too early to predict the economic benefits that accrue. We feel that NTT has treated us fairly and have no serious complaints about the operation of the agreement. We acknowledge that it has not been easy since both sides had to go through a learning experience.

We recognize that many other U.S. firms are very disappointed with the results of the NTT agreement. Clearly, the official U.S. position consistently has been that without significant NTT purchases from U.S. firms the agreement would not succeed. Developments during the remainder of 1983 could well change this current perception among U.S. firms.

COMPETITIVE CONDITIONS IN HIGH TECH TRADE

There is clearly an imbalance in competitive conditions between the United States and Japan that disadvantages United States high tech firms. For example, a U.S. trade deficit with Japan of 20:1 in communications equipment is simply inconsistent with the relative strengths of the United States and Japanese industries. A U.S. market share of less than 10 percent in Japan's semiconductor market is totally out of line with a majority U.S. position in the rest of the world.

Such imbalances must be addressed and reconciled by the two governments to avoid significant worsening of relations and to maintain a spirit of mutual cooperation necessary to the well being of the free world. The recently concluded United States-Japan High Tech agreement may help to do that if it is properly implemented. The U.S. Government, with aid and support from the private sector, must aggressively utilize the opportunities provided within the framework of that agreement if it is to be successful. Motorola has actively supported the negotiation of the agreement and hopes to play a similar role in its implementation.

The imbalance must also be addressed through significant changes in U.S. policy, including U.S. trade laws. By asserting U.S. national interests in high tech industries, negotiations with Japan may prove to be more successful.

Finally, the imbalance needs to be reviewed in the context of the GATT through active use of various dispute settlement procedures. For example, the recent SIA study appears to us to provide a solid basis for a GATT complaint about Japan's targeting policies, which should be pursued if a Government to Government solution cannot be reached soon through negotiations.

YEN-DOLLAR RELATIONSHIP

Exchange rates have been emphasized by many of our business colleagues as a contributing factor in current United States-Japanese trade problems. Certainly the weak yen has had an adverse impact on our business. Most of the experts who have looked at the problem have found no evidence of exchange rate manipulation by the Japanese Government. At the same time, it appears the yen remains undervalued. Part of the answer lies in the Japanese Government management of its financial markets. A very recent Hudson Institute Study concluded that: "All interest rates . . . continue to be subject to an additional policy of keeping the actual rate low — even in the face of high credit demands from the private sector.

It goes on to say: ". . . Japan's extensive system of control's is much greater than that of other countries . . . ."

Most experts seem to agree that Japan's efforts to keep interest rates low and its financial controls do have an direct impact on exchange rates. Absent fundamental reforms of such policies and further reductions in U.S. interest rates is appears that little can be done about the undervalued yen. And even if more realistic yen-dollar exchange rates are attained we do not believe it would have a significant impact on the risks faced by industries targeted by Japan.

Chairman GIBBONS. Thank you, sir.

First I want to commend you and your company for the aggressive manner in which you have been moving forward in this very difficult area. I know what you have done. I want to say on a personal basis I have enjoyed using your pager in this country. The only trouble I have with it is that it falls out of my pocket too easily. I have had to purchase one out of my own private funds because Bill Frenzel will not let me have one out of government funds if I lose mine. So I have bought more than my share of your pagers.

Give us a case history to illustrate how the Japanese are using their industrial policy to your disadvantage and to the disadvantage of American industry in this very sophisticated memory chip.

Mr. LEVY. Well, I think——

Chairman GIBBONS. How did they do it? What specific steps did they take? What kind of subsidies, what kind of preferences do they use to protect their markets?

Mr. LEVY. I think the most significant case is the VLSI program which was conducted in Japan. That is very large-scale integrated circuit technology, the sponsorship of which was basically done under the auspices of MITI and included approximately six Japanese firms.

Chairman GIBBONS. Is this the chip we are talking about?

Mr. LEVY. Yes, it is the chip.

Chairman GIBBONS. We are going to a plant in Japan, and it would help us to understand what we see.

Mr. LEVY. We are talking about the development of the technology that allows the Japanese to produce highly sophisticated integrated circuit chips. The development of that technology and the rapidity with which the Japanese industry was able to advance its position came about, in our judgment, as a direct result of the so-called VLSI program, very large-scale integrated circuit program.

Chairman GIBBONS. When did that begin in Japan, do you remember?

Mr. LEVY. I would say approximately 3 years ago. Earlier than that. It was about 1976. The program was funded both with Government funds and industry funds. But one of the interesting concepts of the program was that a number of large corporations, as many as six, were allowed to all participate equally in the program and therefore all share in the benefits of the outcome of those technological developments.

Chairman GIBBONS. Let me interrupt you there so that I understand this a little better. There were Government funds and then company cooperation?

Mr. LEVY. That is correct.

Chairman GIBBONS. Do we know how much Government funding they put in there? Then I want to come back to the company cooperation.

Mr. LEVY. I think it was $130 million of Government funds.

Chairman GIBBONS. That was the Government seed money that was given out through MITI? This is directly to companies or some research, or what was it?

Mr. LEVY. It was directed at the specific program, which included a number of companies.

Chairman GIBBONS. $130 million does not sound like a lot of money to a Congressman, but I realize to someone who has to make a profit, that is a lot of money.

Mr. LEVY. If you look at it in the sense that then each individual company contributed something on the order of $32 million, as I recall, and you multiply that by about six, then you have got another $180 million plus the $130, which would be a large amount in aggregate for any single U.S. company to fund.

Chairman GIBBONS. Yes.

Mr. LEVY. So effectively, there was a $32 million cost to an individual company. For that they got the benefit of something that represented more like over $300 million worth of research and development.

Chairman GIBBONS. Is that the total amount of seed money that the Japanese Government put in that project?

Mr. LEVY. That is the amount that I am familiar with.

Chairman GIBBONS. All right. Fine. Then they allowed their six leading companies to cooperate.

Mr. LEVY. Yes.

Chairman **Gibbons**. Which under our laws would have been a violation of our antitrust laws. You would have all been in jail had you done that in our country.

Mr. **Levy**. Under the present circumstances, there is a high likelihood that would be the result.

Chairman **Gibbons**. Go ahead.

Mr. **Levy**. Well, the program was quite successful. We acknowledge the competence of the Japanese in this area, but the speed with which they were able to advance their industry by virtue of this cooperative effort put six manufacturers into business. It allowed them to get into the market much faster than would have been possible had each company individually had to do the same thing.

Chairman **Gibbons**. As you would have had to do in this country.

Mr. **Levy**. As we would have had to do here. The result was that they were able to capture a very substantial portion of the total world market in the sophisticated memory chip area.

Chairman **Gibbons**. Did they share that technology between the six companies or with any other companies?

Mr. **Levy**. They shared it amongst the six companies.

Chairman **Gibbons**. Were there any Japanese companies that were cut out of the share of that?

Mr. **Levy**. They were companies that did not participate. I cannot speak authoritatively to whether they eventually got access or did not get access to the technology that was developed.

Chairman **Gibbons**. Let me go to a specific. Texas Instruments has a plant in Japan.

Mr. **Levy**. That is correct.

Chairman **Gibbons**. Do you know whether Texas Instruments was able to get any of the technology that the six companies developed, or were they excluded from it? I realize we are getting in to close things about trade secrets now, but go right ahead.

Mr. **Levy**. Well, first of all, Texas Instruments was not in the original companies that participated. If they did benefit from any of that technology, it would have been after some delayed period that gave the original six a substantial headstart.

Chairman **Gibbons**. Do you all have a manufacturing plant in Japan?

Mr. **Levy**. We do have a manufacturing plant in Japan, yes, sir.

Chairman **Gibbons**. How long before you were able to take advantage of any of this?

Mr. **Levy**. We still have not taken advantage of that. Perhaps I should recite a little history to put it in proper perspective.

Chairman **Gibbons**. All right.

Mr. **Levy**. We entered into a joint venture with a company in Japan approximately 3 years ago. It was on a 50-50 basis. It was basically the initial portion of the manufacturing process for chips was what was done in that factory.

At the end of 1982 we bought out our partner and we now have a 100 percent interest in that manufacturing facility, which is approximately 4 hours north of Tokyo and employs approximately 350 people. But that facility is not in the business of making these very sophisticated large-scale memories at the present time.

Chairman **Gibbons**. You were making the silicon part?

Mr. LEVY. We make silicon parts but not that particular part at that level of sophistication.

Chairman GIBBONS. What share of the market did that give the Japanese in this particular item?

Mr. LEVY. In terms of the world market, they probably enjoy about 67 percent of the so-called 64K RAM world market.

Chairman GIBBONS. Who has the rest?

Mr. LEVY. We have about 53 percent, and there are not hardly any others.

Chairman GIBBONS. So we effectively share that market with the Japanese. We have the small end of the share, though.

Mr. LEVY. Yes. We have the small end of the share.

Chairman GIBBONS. Now, I know the 64K RAM chip is a very sophisticated chip and will do a marvelous number of things. But from what I read in the current literature, that will soon be eclipsed by others. Are the Japanese moving ahead in that area in the same way?

Mr. LEVY. Very vigorously moving ahead in that area. I will not say in the same way that they have a program similar to the VLSI program. In the next generation, what we call the 256K RAM they are moving very vigorously ahead. It is our belief that there are many more Japanese companies ready to introduce products or introducing products in that area than there are U.S. companies. We probably will be the first U.S. company to be sampling products in that area, hopefully by the end of the second quarter of this year.

It is our belief that there are at least five Japanese companies very close to sampling products, some of whom have sampled products already.

Chairman GIBBONS. In this 256K RAM do the Japanese use the same techniques? How much money did they put in? Who was given preferential treatment? And as a part of that preferential treatment, did they exclude competitive products?

Mr. LEVY. In the original VLSI program?

Chairman GIBBONS. Yes, sir.

Mr. LEVY. I do not think that I can speak authoritatively on how the original companies were selected. I just do not know how they picked the original companies that were permitted in the program.

Chairman GIBBONS. Well, did they shelter their market in any way in the 64K development and application?

Mr. LEVY. I cannot say that they explicitly sheltered the market in the 64K. The point is that they were doing the development in a very timely fashion so that there was not a substantial market for 64K's. The 64K was an extension of the 16K. So a 64K could accomplish about what you could with four 16K's. So they had made some substantial inroads into the 16K market and then went on from there to the 64K with the kind of effort that I have suggested.

I think I should point out, since all of these products in terms of processes and technological capability are related to a degree, the advantages that you get from the 64K carry over to a certain extent to help you go on with the next generation, the 256K. From there they will go to one megabit and so will we, to 1 million bits of memory on a chip.

Chairman GIBBONS. Well, in conclusion, do you believe that they commited an unfair trade practice in this? Or are you advocating that we follow their type of lead? What kind of conclusion should an American legislator draw?

Mr. **Levy**. I think the kind of conclusions we arrived at is that the Japanese being a sovereign country can do anything within their borders that they deem desirable and necessary, but that when they bring that product into the international marketplace and when we are forced to compete with product where their cost of development was subsidized, was substantially less than our own, where they were able to shorten their time cycle, where we know their cost of capital is substantially below ours, we feel that we are at a disadvantage and we think that that problem has to be addressed. That is the essence of the targeting practice.

Chairman **Gibbons**. How do you think that we ought to remedy the situation?

Mr. **Levy**. I am not prepared to speak to any specific remedies at this time, but I do think we have to reexamine our trade laws. I think our chairman is going to appear before your subcommittee next week and will be prepared to address this in more detail in terms of some of the specific remedies that we might be able to suggest.

Chairman **Gibbons**. Mr. Jenkins.

Mr. **Jenkins**. Thank you, Mr. Chairman.

I only have one question. Part of your statement indicates that maybe some of the problem is with our own internal laws here as it relates to our domestic industry apparently. You indicate if Japan wants to permit six companies to form an alliance to do R&D, even though they did have some governmental assistance, and you would be prevented from doing that here, then that may open the door for the possibility of some modifications in our own laws here to permit similar R&D projects?

Mr. **Levy**. The possibility for doing combined R&D in this country is being actively explored by both the semiconductor and computer industries in an organization called the Micro Electronics and Computer Corp., which was sponsored by Bill Norris, the chairman of Control Data Corp. MCC has been formed, the specific intention of it is to test our ability to do joint R&D here.

The Department of Justice, the Attorney General, has looked at the formation and essentially has given us as much of a go-ahead as they will ever give; that is, they have said we have ceased our investigation, we understand what you are going to do. So I guess I can say the organization will proceed and we will see how much fruit it will bear. It is just in its infancy.

Mr. **Jenkins**. So you feel there is some room now to do joint R&D?

Mr. **Levy**. We are testing it carefully.

Mr. **Jenkins**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman.

Thank you for your testimony, sir. You are in charge of all of Motorola's marketing in Japan?

Mr. **Levy**. All of our Japanese operations in Japan as well as our strategy with respect to competing with Japan on a worldwide basis.

Mr. **Frenzel**. How do you sell your product in Japan, for instance, to NTT? Do you have Americans over there, Japanese? How do you handle it?

Mr. **Levy**. We have some Americans in Japan but the contacts with NTT are done mostly with Japanese with some Americans participating. In terms of how we sell our product in Japan, almost entirely through the use of what we call in OEM sales force, that is, our own sales people and also through independent distributors. We sell in the semiconductor area approximately 60 percent of our product through independent Japanese distributors and the other 40 percent goes through our own employees, our own sales force.

Mr. **Frenzel**. Do the Japanese distributors sell your products of the kind they are selling exclusively?

Mr. **Levy**. No. In general, they may carry competitive lines.

Mr. **Frenzel**. Is that the way you would prefer to do business?

Mr. **Levy**. It is not necessarily the way we prefer to do business, but I must say that we use independent distribution here in the United States and the same conditions do apply. An independent distributor will usually carry more than one line and they may, indeed, be competitive.

Mr. **Frenzel**. If you are not satisfied with that distributor, is it relatively easy to find another one?

Mr. **Levy**. It is not relatively easy in Japan because the terms under which you engage a distributor are rather binding, and it is not easy once you have established the relationship to change distributors, even if the performance of the distributor is not exactly what you would like.

It is much easier to disenfranchise a distributor here and make a change than it is in Japan.

Mr. **Frenzel**. Do you have American personnel that you train to do sales work in Japan? Do you have Japanese-speaking Americans who work in this field?

Mr. **Levy**. Unfortunately, the answer to your question is we do not really have a good program for training people to speak Japanese. We have, on occasion, had people very fluent in Japanese, Americans very fluent in Japanese who have headed our operation in Japan. I guess I would have to acknowledge that that is one of the deficiencies of most U.S. companies, and we certainly plead guilty to not providing adequate training in the language, in the culture and in the customs in terms of sending people into Japan to do the work for us.

Mr. **Frenzel**. Is that partly a function of the size of the market?

Mr. **Levy**. Yes, I would say it is partly a function of the size of a market. Partly a difficulty in learning the language and the culture, and I guess partly a belief on my part that the most efficient solution to the problem would be to run our operation with Japanese nationals and not with Americans.

Mr. **Frenzel**. The Japanese nationals that are helping you sell to NTT, are they employees?

Mr. **Levy**. They are employees of our corporation, yes, sir.

Mr. **Frenzel**. They are theoretically full time, permanent?

Mr. **Levy**. Oh, yes, absolutely.

Mr. **Frenzel**. How do you market, say, in a European or Asian country, other than Japan?

Mr. **Levy**. In much the same manner. We have our own sales personnel who work directly for our corporation, and we do a certain amount of our sales through independent distributors. There really is not a tremendous amount of difference. The ratio of product that moves through independent distribution as opposed to through our direct sales force may vary from country to country. For instance, in the United States in semiconductors, 70 to 75 percent of our product is sold directly by people who are employed, full time employees of Motorola, and only 20 to 30 percent through independent distribution.

Mr. **Frenzel**. This subcommittee has taken an inordinate interest in the NTT process. We met with Dr. Shinto and his famous predecessor on a number of occasions. In your testimony you indicate that you are satisfied with the progress. Are you satisfied with the rate of progress?

Mr. **Levy**. I would say so. I would say that the rate of progress certainly is not being—in the two programs that we are involved in, is in no way being limited by NTT. We are in production on the pager of the type that the chairman referred to. We manufacture and are in volume production and supplying pages to NTT at the present time. We probably have over 40,000 U.S. pagers in the field in Japan as a result of the NTT program.

Mr. **Frenzel**. It is rumored on the street that when you commenced selling pagers, at least on the original contract, the price NTT wanted to pay was more than your offering price. That may be something you do not want to comment on, but if you can, could you verify that rumor?

Mr. **Levy**. I really would not care to comment on it except to say that the price paid by NTT to every supplier is exactly the same. There are six suppliers of pagers to NTT, and we all are paid exactly the same price for the pager.

Mr. **Frenzel**. The allegation, of course, was that NTT was protecting the Japanese suppliers who were used to a favorable rate.

Mr. **Levy**. Well, the volume is split at the present time since our appearance on the scene, relatively equally. When we bid the program, we bid it on the premise that we did not want to get into the business unless we got a certain quantity of pagers. The quantity that we asked for at the time was larger than NTT felt they could obligate themselves to give us.

So we thought about the problem and said all right, we will still participate in the program if you can assure us that we will get at least as much volume as any other Japanese supplier, and NTT agreed to that—split the business equally six ways for the 1982, fiscal 1982 buy. So we got one-sixth of the business, as did each of the other five vendors.

Mr. **Frenzel**. As far as you know, everyone is being paid the same per pager?

Mr. **Levy**. As far as I know, everyone is getting the same per pager. This year, the formula of split was a little bit different. They split the pie slightly differently by giving a slightly larger share to the lowest bidder. But it turns out that roughly, the other five of whom we are one, are getting approximately 16 percent of the business and the lowest bidder is getting about 17 percent, on that order.

Mr. **Frenzel**. Thank you very much for your testimony. We will look forward to hearing from the chairman next week.

Chairman **Gibbons**. That does not sound like competitive bidding to me. I know a president of a company that just went to jail in my district for doing that. Not that you all have done anything wrong under American law, but if you were bidding on contracts in America and you came up with that, it would be off to jail. I do not think that is what we were pushing the Japanese for when we were pushing them so hard on NTT.

I cannot imagine six companies all supplying pagers, all of them bidding for it and then everybody gets to sell them at the same price.

Mr. **Levy**. But it turns out, sir,—just so there is no misunderstanding—everybody is asked to supply at the price of the lowest bidder. Now, you can elect not to supply, if you wish, but there is a bidding process.

Chairman **Gibbons**. That is interesting. Do we do that in the United States? Are we allowed to do that in the United States? Do you know?

Mr. **Levy**. Not as a general rule.

Chairman **Gibbons**. I am not criticizing the Japanese for it. I am just saying it is one of those cultural differences. It is a heck of a lot different than I had ever thought.

Mr. **Frenzel**. Dr. Shinto tells us that NTT is amazingly resistant to change.

Chairman **Gibbons**. Well, just because it is different does not mean it is bad. There may be some real advantages to having everybody go to the lowest bid if you want the business.

Are there any differences in the quality of these pagers?

Mr. **Levy**. There is a quality specification.

Chairman **Gibbons**. Sir?

Mr. **Levy**. There is a quality specification on the pagers which everybody is required to meet, and if we, for the sake of argument, were not meeting it, we would not get our share of the business, and that would be a legitimate reason for either being eliminated as a vendor or having your share of the business reduced or whatever.

Chairman **Gibbons**. Suppose you wanted to give them a better product.

Mr. **Levy**. If I were to give them a better price——

Chairman **Gibbons**. Product.

Mr. **Levy**. A better product?

Chairman **Gibbons**. Higher performance; once that had more range for a pager, or greater clarity, or lighter weight or stayed in your pocket better or something like that. Would you be prohibited from doing that?

Mr. **Levy**. I will be in a much better position to respond to that kind of a question in about a couple of weeks time because up until now, we have been responding to their requests for a quotation. If I were to bid a product that was not in conformance, even if it might be better in certain ways, it would not conform to the request that they have asked for. Incidentally, the same thing would be true here on a military bid. They tell you what it is they want and you respond to that particular request for quotation.

Now we have, however, submitted to NTT certain unsolicited proposals along the lines of what you are suggesting. I am going to Japan this week to discuss with NTT their interest in those proposals, and hopefully, we will get some affirmative response.

Chairman GIBBONS. I can see we are going to push on NTT a little more.

I thank you for coming here and helping us with this problem. We look forward to working with you, and I hope someday we will have a chance to visit your plant.

Mr. LEVY. We would love to have you, and we hope your trip to Japan is very successful

Chairman GIBBONS. Thank you.

Our next witness is our colleague, the Honorable Richard Gephardt, a Member of Congress from Missouri and a distinguished member of the Ways and Means Committee.

STATEMENT OF HON. RICHARD A. GEPHARDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. GEPHARDT. Mr. Chairman, members of the subcommittee, it is with great humility and a sense of inadequacy that I come here to testify before you, because I realize that my information on this subject is far short of what yours is.

Chairman GIBBONS. Dick, don't feel bad; we are all inadequate on this subject. I think we have proved that a number of times, so welcome to the club. Jump in the tub with us.

Mr. GEPHARDT. I was recently in Japan with a Japan society trip, and while that obviously does not qualify me to even testify today, it did lead to some experiences and exchange of information that greatly excited my interest in the subject. Being from an area of the country that is particularly impacted by the imbalance of trade between the United States and Japan, a number of things came to my mind that I wanted to express to the subcommittee for their consideration.

I think that I came away from that experience with the realization that all of us in the United States and even most of us in the Congress do not really comprehend the nature of the world marketplace. And I think that we do not accept that our domestic market, while it may be the biggest in the world, is not enough to sustain our economy.

I think not enough of us understand that we need trade, international trade, we need to export, we need to understand that one in six jobs now depends on exports. There is a general failure here in the country to look at the whole picture.

We have a staggering trade deficit with Japan; we also have a large trade surplus with the European community, and it is both foolish and unrealistic to expect or demand that the United States have completely balanced trade with any one country.

Until recently, as you know, our current account balance was positive. Until recently, the Japan current balance was negative. While we have had a huge trade deficit in our merchandise area, we have had a surplus in services. Over 60 percent of our work force is now employed in the services sector. Those facts are all well known to everybody in the room. Not too many are aware of them, however, around the country.

It seems to me we should recognize the pitfalls in protectionism. We have examples in St. Louis. The industrial fastener industry, those people who make nuts and bolts, are being priced out of the market and the only reason that they cannot compete is because they have to pay more for steel than their competitors in Korea and elsewhere. Excessive union demands are not really the problem. Steel import quotas that raise the price of steel in the United States are. Trying to save jobs in the steel industry can lose jobs in other industries.

I am also worried by what seems to be an increasing tendency for us to use our trade problems as a scapegoat for other problems. I do not deny that our huge deficit with Japan is a serious problem, but it seems to me we cannot blame all of our ills on the Japanese.

I think that the growing anti-Japanese attitudes are indicative of this trend, and on that score let me just relate one thing that really concerns me. For a long time now, auto workers in St. Louis have been very concerned and angry and frustrated about the imbalance in trade with automobiles. But just recently, I have been impressed by the fact that a number of very well-educated, sophisticated business people, the heads of some of the major corporations in my area, have come to me and said that the root of all of our problems is our trade imbalance with Japan and that we have to do extraordinary, almost radical, things in order to solve that problem.

I guess I am not telling you anything you do not know, but it has been interesting to me and disturbing to me that the feeling about the Japanese imbalance has reached the level of the CEOs of some of the major corporations which do a great deal of world trade, perhaps not in Japan but in other areas. It seems to me that if that kind of feeling persists, then we have a very substantial political problem in the whole array of trade questions.

In just looking at this problem it seems to me that the most glaring flaw in our trade posture is the lack of a strategy, the lack of overall plan. Not only does the administration, in my view, lack a working strategy for explaining its policies to Congress and the American people, but when I was in Japan, one of the most common questions I was asked was "what is it that your administration wants?"

How can we possibly expect to realize any results from our negotiations with the Japanese if we fail to present a coherent and comprehensive list of our demands?

I think we have too many parts of our government trying to solve these issues, and they are working sometimes at cross purposes. I am sure we have a trade policy; I am not sure that many Members of Congress know what it is or understand it or have any part in developing it.

I think because of that and because of the multimessages that we are giving to the Japanese and other trading partners, we are confusing them by speaking with conflicting voices and giving the sense that there is no American trade strategy.

There is a lack of direction. We emphasize restrictions on beef and oranges—that question came up over and over and over again in our discussions, but in my view, these are the most politically senstive issues for Japan. Even if we were to get unlimited access for beef and oranges, there would be little difference in our overall trade balance.

We are at a point where we have got to have priorities in this country as to what we want in a trade policy. Maybe that is asking too much, but I think the failure to do so will result in the collapse of our overall trade situation and will create political problems for us that we simply cannot manage.

We need to closely look at the way our trade policy is created and organized. Perhaps a new organizational form is needed. I know there has been a lot of talk about that. I am sure that this subcommittee has been involved in those discussion. Changes should be made so that we make clear and specific requests, so that we could have a more coordinated trade policy and so that our demands could be more realistic and more meaningful.

We obviously need more quiet diplomacy and consultation with our trading partners and fewer public threats, but when public threats are used, they should be used as part of a strategy to try to achieve an end.

I think that the renewal of the voluntary import quota by the Japanese on autos is a positive move, but it is only temporary. I really wonder how much coordination and consultation with the Congress went on in the reaching of the third year of that agreement, and whether or not the agreement is structured as well as it could be structured to achieve as much political relief as one might want.

I am particularly glad that you have chosen to make the dollar-yen exchange rate one of the principal focuses of these hearings. I think this is a long-term solution to our problems, one that is very important. We do not usually consider the international ramifications of our domestic economic policy, and we should. Especially as we understand how important international trade is to our economy. Obviously, we are sacrificing our trade policy in this instance for a domestic economic policy.

I doubt that we ever make that connection, because what happens in that dollar-yen relationship is always looked at as a subissue and never a major issue in domestic economic policy. If we are always going to make that tradeoff in favor of domestic economic policy, then shouldn't we reapproach the whole question of how we set exchange rates, and what we did a few years ago to that mechanism, and whether or not it is still appropriate.

We have to look carefully at the question of the role of export subsidies; particularly, do we want to become involved in the escalating export subsidy price war. In the Budget Committee deliberations we have had a big discussion about Eximbank and whether or not we should put a lot more money into Eximbank to compete in the aerospace industry, for instance. But yet, those decisions are never made in the context of what should be our overall trade policy. Do we want to escalate and get into what may be an export subsidy price war?

Finally, I would be remiss if I were to fail to mention the role played by such protectionist legislation as domestic content. I am sure that everyone here knows. I am a cosponsor of this bill. I voted for it in the last session. I do not consider it contradictory for me to sit here and talk about the importance of trade and to be for free trade and at the same time, be a cosponsor of that kind of legislation.

It is not my first choice as a remedy, but I think if we do not make some progress in making Members of Congress and the public at large understand what our trade strategy is, then legislation like that will continue to be brought up and will continue to pass in one House or the other and may ultimately become the law of the United States.

That would not be a very good result. I think that that would probably be the beginning of the end of a very successful trade relationship, but I am here to tell you that from the tea leaves I read, that is an inevitable result, even if we have economic recovery, because of the changing nature of our economy.

We must become very, very aggressive in both educating ourselves and our constituents about the importance of trade. I believe that question has to be readdressed both within and without the Congress and it has not been. We have to rethink and reunderstand why we believe in free trade. If we believe it to be good, then to come up with a coherent, sensible, intelligent trade policy and to try to implement it through various means.

It is clear to me that other countries like Japan have been a lot more successful at doing that, perhaps because it has been more necessary for them to do so, but I think we are at the point where if we believe it important, that we have to do that and our failure will frustrate any effort politically to sustain any policy for trade at all.

I appreciate the opportunity to be here. I am not sure I have said anything to you that you have not said yourselves or know yourselves many times over, but I felt impelled to come here and say it because I feel so strongly about it.

Chairman GIBBONS. Well, I appreciate your coming here and I think you have made a good statement, and I wish you were on this Trade Subcommittee. Now that you have solved all the social security problems maybe you can move over and help us. We need all the help we can get.

Mr. GEPHARDT. I wish I could do better in trade than I have done in social security.

Chairman GIBBONS. Let me state, because we are talking now as Member to Member, we do probably need a better trade policy. We need better education and we need more effective laws. We deal uniquely, though, with about 160 or 170 other sovereign nations around the world, and I have never been very successful, except maybe in 1945, in inflicting my will upon anybody where they are as sovereign nations.

The great loss of life and the great sacrifice that everyone made, we were limitedly successful in the 1940's in inflicting our will upon the Japanese and upon the Germans and a few other people. But since that time we have been frustrated in doing that and we have gone to international arrangements to try to negotiate our way in a more rational world.

Now, I believe that the United States trades for a couple of purposes. One purpose, of course, is to promote our national security.

Second, we trade so that we can live better with a higher standard of living. We do not trade to have a surplus or deficit or to strengthen our currency or really to do a lot of other things, and we should not. We should only trade to strengthen the standard of living of all Americans, not one sector or the other sector.

I am like you; I cringe a little over the beef and citrus thing. It is not high on the American agenda because those two products happen to come from Florida. It was high on the agenda before I ever got to this Congress. And I do not spend a lot of time trying to push those things myself because I realize they look parochial and because I realize if the Japanese ate every orange in Florida and ate every cow that is produced in Florida, it really would not have a heck of a lot to do with our balance of trade with the Japanese.

First of all, they could not eat that much beef and they could not eat that many oranges, so our problems are much greater than that.

We have seen a dramatic growth in trade, export trade in the United States. When I first sat on this committee, or I guess in 1970 when we had our first battle over trade, the United States was exporting about $25 billion worth of products a year and reflecting that many jobs. The Export Task Force just sent me a notice yesterday that exports were up to, in the merchandise area alone, excluding military, to $211 billion.

From $25 billion to $211 billion in 13 years. Some of that is inflation, but a lot of it is new jobs. In fact, 80 percent of all the new jobs that have been created in the United States since 1976, so people tell us, have been created in the export industry.

Our imports have also increased in that time. But if you add goods and services, it is not only $236 billion, but it is $276 billion, up from $25 billion to $300 billion—I am giving you 1981 figures now, and this is in goods and services excluding military. The United States exported in 1981 $376 billion worth of goods and services, up from $25 billion.

I do not know of any area except the national debt where America has had such a growth. It is amazing. One out of every three jobs in agriculture, one out of every three acres in agriculture; one out of every seven jobs in industry is an export job.

Our policy has not been perfect and it is not as good as I want. It is open to wide criticism, but I think we have to look at all of this and where we were and where we are. I do not want to emulate the Japanese. I do not want my Government telling me what product is going to be preferred in my market and that I have not got a right to compete freely on the best price, the best service, and the best product in that market.

Apparently the Japanese do. They select a favored few. We would have more scandals in this country if we started that and it would make what is going on, or apparently going on, over at EPA look very mild, or Teapot Dome look like a tea party rather than a scandal. So I do not know how they avoid those scandals or whether they are able to just sweep them under the rug, but in this country I do not see how we ever could.

I do not want our people to become a bunch of workaholics, and I do not want our people not to have the mobility in the labor force to move from one job to another when you get darn good and ready to. Yet, we need to do better.

Certainly you come from an area that is afflicted by an industry in transition, the automobile industry. The automobile industry is moving, as I see it, from a labor intensive, low technology, high pay industry to a less labor intensive, higher technology industry. And jobs are going to be just dropped all over the place.

We ought to have a policy, as Mr. Pease points out, to give those people who are caught in that transition some hope and some mobility to find a new job. We have not been very successful in that, Dick, and we need your help on doing that.

I concocted a program in the early seventies that was known as Trade Adjustment Assistance to improve upon one that had been concocted in the sixties. It has not worked. It just has not worked. It turns out it just extended unemployment compensation and very little adjustment, and even that is being phased out.

We have got a lot to do, and I appreciate your fertile mind, your sincerity, and I appreciate you just coming here and sitting with us today, and I appreciate your listening patiently while I preach up here.

I do not know what question to ask you, so I am going to pass that up. But if you would like to observe on my observations, I would be happy to hear you.

Mr. GEPHARDT. Well, I would just say two things to your points, which I think are all excellent and well taken: First, that the statistics you cited about the growth of export industry in the United States are probably not known by any American outside the Beltway, or very few.

Chairman GIBBONS. It is startling to me. It is startling to me.

Mr. GEPHARDT. I think the other statistic that we need to couple with that is what trade has meant to employment in the United States.

The key political issue, as you well know, is the employment balance or imbalance. I do not know how you calculate that. I do not know how we wrap our minds round that. But it seems to me that if that dimension could be added to that set of statistics, then there is a lot of information there that the American people need to understand. I do not know how you get them to understand it, but it has got to be understood.

Chairman GIBBONS. Well, services are really highly labor intensive.

Mr. GEPHARDT. I understand that.

Chairman GIBBONS. Educationally intensive. In other words, it requires dreaming of a better system and making it work better to go a long way in services.

The services were not as great as I thought. It says here in this Trade Task Force publication that services in billions of dollars last year for exports was $40 billion. I think that is about right. I was thinking it was a little higher than that, but they say $40 billion. These are Department of Commerce statistics. I am a little skeptical of all statistics, but they are the best thing we have.

Mr. GEPHARDT. Sure. I think there is an obvious need to try to make these understood and known to a wider group.

The other point I would make is that from a political viewpoint, when an industry is heavily impacted, like the auto industry has been in the last 2 or 3 years, you have a tremendous political problem in certain areas of the country, and if this happens in other industries where there is targeting by Japan or any other country and you have a heavy quick impact, you are going to have a heavy, quick political problem.

It seems to me that that is something that you have got to always try to manage in the best way you can so you do not destroy trade. It is in our interest, it is in every other country's interest that wants to trade with the United States.

In my view, part of dealing with it at a governmental level is being willing to have—and I hate to even use the words because they mean so many different things to many different people—but to have some kind of an industrial policy. I am not saying set up an RFC and kick money into an industry and pick winners and losers and all that business.

I am saying that if you are to manage that kind of a transition, if we do not want to have, as you said, an economy run as the Japanese economy is, where you do pick winners and losers and you do assign capital and all those things we do not want to do, then at least you must have a government mechanism for giving industries information about where they are and what is happening to them and what is happening in other countries vis a vis them, which I do not think we do in any organized way.

You have also got to be willing, at the Government level, to cook some deals, for lack of a better way to say it, like what we did when GATT was passed, where we went to the unions and we said, we want to pass GATT and we are going to have training adjustment assistance, or whatever you call it, which, as you point out, was never done very well and we have had lots of problems with it.

But that was part of the critical mix that made that happen. We seem to be unwilling to do that, to take that aggressive role as Government—and some would suggest we be a lot more aggressive, but I would not go that far. If we are unwilling to give information and we are unwilling to try to work with the industrial sector in dealing with the competition that we see coming, when other countries do heavily target, then I think we leave ourselves open to the inevitable result of protectionist pressure that is going to be more and more difficult to overcome.

Chairman GIBBONS. I will tell you a little story. I apologize for taking up so much time.

A little over 2 years ago, I sent a person over to the Department of Commerce to just do a little friendly spying on what went on over there, because they have got so much information that they make available to American business. I wanted to see how it was being utilized by American business. It is open to everybody. You can just wander in and get the information.

The report came back to me that there were not very many U.S. concerns who ever wandered in to get the information. Maybe they did not need it, but that the office was always full of Japanese. They were in there ferreting out the information that we were making public and apparently doing something with it.

They were using the services that our Government was providing for our citizens and for anybody else that walked in. I guess the Russians could have walked in or anybody else and gotten the information. But the Japanese were just all over the place. They were aggressively seeking information, digging it up, and apparently applying it to our market—statistics, reports, opportunities for contracts, and everything else.

You know, I am not criticizing our Government for doing that. It is a good purpose. But I wonder whether American businesses have been as aggressive in going out and getting things and taking advantage of the system as others have.

Mr. GEPHARDT. Let me put a twist on that. I agree with you. I do not think that at MITI they wait for them to come in. They have them in. I do not know how they do it, but they show up and they get the information.

Information is power, for lack of another word. Information is essential to being a competitor in today's world. Whether you want to be a competitor or not, if you just want to stay in business you have got to have information about your competition.

It seems to me that the Government has to take an aggressive role. If the Government wants to have an open trade policy in this country, the Government has got to take an aggressive role in both compiling information and seeing to it the information is received. They may not understand it, they may not want to hear it, but it must be received by the industries that need to receive it in this country.

Chairman GIBBONS. Mr. Pease.

Mr. PEASE. Thank you very much, Mr. Chairman.

I am glad to welcome our colleague from Missouri today and I want to compliment him on his testimony. It is even more valuable than perhaps you realize. At least it is valuable to me, because what you have brought to this hearing today is the political element, the fact that we deal not only with trade experts but we also deal with American citizens who are our constituents. If we forget that, we are going to lose our traditional free trade posture in this country, I think that is certainly an important factor in our relations with Japan, the subject of this hearing.

In automobiles, for example, you sponsored domestic content legislation and so have I, not because we think it is the end-all and be-all of trade policy, but because the auto workers in our districts have been unemployed and want some kind of action. We probably both settled on domestic content as less restrictive than some other things that could be adopted.

Earlier today our colleague Mr. Stark proposed legislation which would set a limit on the gap that could exist between exports and imports on a bilateral basis between Japan and the United States. He was suggesting that we would allow them to have an advantage of $10 billion in exports to us, but once that limit was reached then the understanding would be that if they wanted to sell more to us they had to buy more from us.

I think on its face that is a violation of the principles of free trade, but it seems to me that Mr. Stark has a point in terms of the political aspect, which you mention in your own testimony.

Our trade deficit with Japan is growing at an alarming rate. It seems to me that if in the name of adherence to free trade and let that $20 billion bilateral trade deficit continue to grow, we are going to experience political repercussions in our districts that you and I cannot handle, and a lot of other members cannot, either. The result will be a build up of pressure for restrictive measures in Congress to the point where they cannot be resisted.

I guess I am guilty of a little bit of soapboxing. But I wondered if you would agree with me from a political point of view that we have to address those trade imbalances with Japan, if for no other reason than to keep the pressures from building which will lead to what we would consider unacceptable ways of addressing the problem.

Mr. GEPHARDT. Well, I appreciate your point. I think the bill sounds a lot like an idea that Lester Thurow made some weeks ago. I suppose it comes from that.

Mr. PEASE. It surely does.

Mr. GEPHARDT. It is an interesting and in some ways an attractive way to deal with the political equation, which I think is the bottom line of what I am trying to express. It obviously, like domestic content, has a variety of technical and other problems. As you say, it probably violates basic principles of open trade, policies that we have pursued in the past.

But it is an answer, although it may be a limited one and an imperfect one, to the basic political problem we have got. When there is penetration from one country to the other's market to the extent that now exists between us and Japan, you begin to endanger the ability to carry out any trade policy at all. That is the problem you face.

There are a number of ways you try to address that. I have tried to mention some that I think are important: Being more aggressive about having a trade policy, doing better education in the country, encouraging voluntary agreements, which are really a microcosm of that overall kind of agreement that you talked about. The voluntary auto accord is simply one industry doing exactly what the Thurow idea suggests.

I do not know the best way to go. I do know that we have got an urgent problem. I really believe that. And maybe, again, I am from the wrong part of the country, and I am sure if you are from the State of Washington or a grain area you look at this very differently because you are selling a lot of grain to the Japanese.

But I am just afraid that the future, even with recovery, holds the seeds of destroying any trade policy. We have got to be urgent, it seems to me, about doing everything we can think of to try to preserve as open and as free trade as we can.

I do not know what the answers are, but I will be with you to search for those answers. I think your subcommittee has a key role in this. You are in the cockpit, it seems to me, of the Congress in deciding on a trade policy. I urge you to be as aggressive as you can be in trying to talk to the Members of the Congress, in trying to get the administration to meet with Members of the Congress to try to devise a better policy.

I thank you for your question. I think your question is well taken.

Mr. **Pease**. One other thing. As I recall, you have an aerospace industry in Missouri, too, do you not?

Mr. **Gephardt**. A good bit. We do not have the commercial side; we have the military side. But the company there is obviously one of the giants.

Mr. **Pease**. I wonder if you might want to comment on the point I made earlier that the Japanese have apparently decided just recently to target the U.S. commercial aircraft industry and build up a Japanese aircraft industry. It seems to me that since the United States holds such a preeminent position currently that that can only be considered to be an unfriendly act. They could have picked any area to go into and they have picked one where we know—and they know—that success on their part will reduce U.S. exports in a dramatic way.

I guess I would just like to ask for your comment on that.

Mr. **Gephardt**. Well, I think whenever we read that someone has been targeted, that it becomes another political problem. But I don't think we can tell the Japanese or anybody else how they ought to do business or how they ought to run their country.

I would just hope that in all of these things, we could use a little sensitivity to the overall problem, and I am not sure that is done very often. I also think that we need more communication on a broader range of issues than "Gee, we wish you would get rid of nontariff barrier number 13 on paperclips." We should be talking about the broader question of how do we maintain this relationship, and what can we both do to see that that happens.

Mr. **Pease**. Thanks very much.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman.

I think you have done us a good service by focussing on the political aspects. As I understand what you have told us, and maybe this is an unflattering characterization, it is that we have a political problem and that whatever our trade policy is, it isn't solving your political problem.

Mr. **Gephardt**. I think that is absolutely correct. Let me say it a little more strongly if I can. I think we have a political crisis on trade, and I hope I am not overstating that to you. I know you all hear this all the time in your own districts at one time or another. Let me just say to you that my real perception is that it has escalated beyond a normal political problem.

When you have someone who is highly educated, highly sophisticated, who runs one of the biggest corporations in my area, spend a half an hour with a red face talking about how we are in a war with Japan over trade and economics and how we have to take drastic, radical actions to solve it, I begin to think we are in a crisis, and not just another normal political problem.

I would suggest to you that he is not unique, and he is not in a business that is impacted by Japan, and he is doing business around the world and he has decided in his own mind that this is probably the root of all the evil in the American economy today.

Now, you know, it is not important whether he is right or wrong. What is important is what he thinks, and he is an opinion maker and he is someone who has a lot of influence in that area.

Mr. **Frenzel**. I would agree. All of us sophisticated folk have red faces.

But the problem you have confronted us with is that if we should go to Japan and say, Japan, you are magically going to break down all of your barriers and you are going to start buying all of the things that Americans produce if you are one inch better or one inch cheaper, if you get all done with that and, as one of our earlier witnesses indicated, the trade balance with Japan grows less favorable and your auto workers are still unemployed, then that trade policy by your political test is unsuccessful.

Mr. **Gephardt**. I think that is what I am saying, that even if we do everything correct in terms of negotiating on both tariff and nontariff barriers, we make great progress and we can at some point say we think there is absolute fairness back and forth, if there still remains an intolerable imbalance—and I do not know how you define that, but that is the only way I can say it to you—then we have still got a very real problem and we have got to solve that problem.

Mr. **Frenzel**. Let me put it another way. Supposing we go to Japan and we make an arrangement, or with the whole world, and our trade balance with Japan is dead even, maybe even a slight plus with us. Your auto workers are still unemployed. That policy is also unsuccessful.

Mr. **Gephardt**. Well, I do not think it is, and the reason I do not think it is unsuccessful is because then you have people like me and others in a position where at least intellectually, we have got to then make the case to the American people. It is very hard to be able to convince anyone in my constituency or your constituency that the root of the problem is not the Japanese or the Germans or whoever it is that is penetrating the market when that is the case, when the actual penetration is going on.

It seems to me you can make that case if you do not have that kind of an imbalance. We have had times in our history, many times, when certain sectors of our industry have fallen apart, and we have not always in the past gotten rid of free trade in order to solve that problem.

Mr. **Frenzel**. I just asked one of our previous witnesses, Mr. Stark, if as long as we could negotiate a $10 billion differential with Japan, then would not the EC have the same kind of moral basis for negotiating the same agreement with us.

I think we are getting into a bit of a problem here. You have alleged that we do not have a trade policy. I think we do. I think our trade policy is to maintain a relatively open world trading system knowing that everybody protects something. Earlier witnesses have indicated to us that we are just as protective as the nations at whom we are pointing the finger, and that we all have national security interests, food security interests, cultural security interests, and then just some plain old raw protectionism, which we have plenty of in this country.

I think we are doing our best to sort out the equities. We have a couple of industries in the United States which are not competitive, and they need, according to them and those who represent them, some special protection. We have asked the Japanese, and they have voluntarily decided that they are going to withhold shipments of automobiles from the United States.

That is not enough, because our industry has not gotten well immediately, and we still have unemployment.

I am not wanting to be a great defender of Japan, and based on your testimony, my judgment is that you have misread the Japanese when they give you all this garbage about mixed signals from the United States, and they do not understand what we want. The Japanese have wonderful multiple ears. They choose to receive mixed signals. That is the most clear frequency they have.

They look around shopping for mixed signals, so that they can say, hey, we do not understand what you guys want.

We have given them clear signals, and we have given them, through Dent, and through Strauss, and through Askew, and through Brock, and through an endless succession of people—they know what we want. They know it with exquisite clarity. They feel they cannot do it sometimes, and my judgment is, that is a mistake.

I consider Japan to be among the most closed markets in the world. I know the Japanese know this, and they are resistant to it, and I would agree with anyone that says some day they are going to get penalized for this in the world, because we are going to do something silly, like pass domestic content. It is going to hurt them, and it is going to hurt us, and it is going to hurt the whole world.

But I am not sure where you are leading us with a recommendation that we attack perception or we attack our own problems by going after somebody else. I think we have to—I believe that our policy is responsible, and I believe that it is best for world prosperity in the long run, and I also agree that we have to do something to put our own house in order, but I am not sure that we should go out looking at some foreigners, whether it be Japan or EC or anybody else that has restrictive policies, and they all do, I guarantee you, and say, we are going to take a crack at them, because that is going to make our guys at home feel better.

I do not think it is going to put them back on the payroll. I think those take other solutions that my good friend, Don Pease, is trying to work on, and others, but I am really nervous about making trade policies some kind of a captive or a weapon in trying to solve what our mostly domestic problems are, which stem from a variety of causes that we have not done much about.

Mr. **Gephardt**. I think we are talking about transition mechanisms. That is what the auto agreement is. It is an attempt to manage the political problem and to manage the real problem while that industry changes.

TRA is part of that, which we have not done very well. That is another transition mechanism. The auto agreement may or may not be constructed right. I do not know whether it is or not. It did not do much for the last 2 years because of the economy. It may do a lot this year. I do not know. It depends on what happens with car sales, I suppose.

All of those are appropriate, but all are transitional. I do not suggest to you that we can or should solve our political problem by putting in long-standing permanent protective mechanisms. I do not think that is what we should do.

I am suggesting to you that there are a variety of things that we are doing and a variety of things that we can do to try to insure that we have the ability to have as free and open trade as we can, and I think there are some things that we could do that perhaps we are not doing that would make that easier.

Mr. **Frenzel**. Well, I appreciate your testimony. I think it has been fun to discuss these matters. Our committee will have its belly full doing this for the next couple of weeks.

Mr. **Gephardt**. I look forward to continuing to——

Mr. **Pease**. I would just like to make the point that Mr. Gephardt is really on target. He has, I think, tried to express what a lot of Members of Congress feel. Probably a majority of members have been, some of them, successful in holding off so far, but there is the perception on the part of industrialists and educated people as well that Japan is not conducting itself in as responsible a manner as a leading citizen of the world should.

I think in a political body we have to deal with perceptions. It seems to me that if there were no trade imbalance with Japan, to go back to what Mr. Frenzel said before, and we still had problems, you and I would be able to stand up in front of an audience and say, maybe we have problems, but it is by definition not Japan, because we do not have a trade imbalance.

If there is a trade imbalance, then we are going to be pressured as politicians to do something. Our constituents demand that we come up with a solution. Their solution may be brand X, do this, which may be a god-awful solution. The traditional response of politicians who recognize a god-awful solution when they see it is to say, well, no, I cannot support X, but I am supporting Y, and if Y is a good solution to the problem, so much the better.

But even if it is tangentially related to the main solution, to the offered solution, and it has even any hope at all or appearance of success, then I think the politician can say, the reason I am not supporting your proposal X is, I am supporting Y or Z, and hold off for a substantial amount of time jumping on the bandwagon for a solution which the politician knows is not a good solution.

People, thankfully, like Mr. Gibbons and Mr. Frenzel, are able, because of their own strong convictions and strength of character, to stand up in their districts and say, I do not care, I am a free trader, no matter what.

I suspect we are reaching the point where that is not a majority of the Members of Congress.

I guess what I am pleading for, and I think you are, too, at bottom, is to be able to have some positive response, some positive suggestion so that Members can basically hew to free trade principles, and that we do not get run over at the last minute and something jams through that none of us will be happy with and will not contribute to our competitiveness in the long run.

Do I read you correctly? Is that what you are saying?

Mr. **Gephardt**. I think you said it better than I can say it. One thing that might help, I guess Bill Frenzel is saying that if you cannot stand up and tell the facts about where we are on trade, which may be pretty good over all, that you are not going to be able to do it even if the trade balance was even with Japan.

Mr. FRENZEL. My judgment is, if there were not a Japan, the auto workers would have to invent it.

Mr. GEPHARDT. That may be the case, but they do not need to invent it, because they can point to a very real penetration in their market. It may or may not be the cause of their problem. Even if it were even, they probably would not go back to work, but the fact of the matter is, there has been an incredible penetration in their market.

Now, maybe I should be able to stand before them and say, yes, but if you look at the overall trade balance of the United States, we are even, even with oil. We have a tremendous surplus in our favor with a lot of other countries, and maybe that should be enough to send them off.

All I am saying is that I think it might be useful if somebody got that information out on a more regular basis to members so that they could at least confront it if they do not deal with it. But I think as long as there is a penetration to the extent there is, it becomes a very difficult case to make.

I guess I am saying that, as Congressman Pease said, there have to be some transitional programs. There have to be some alternatives that one can point to to try to deal with that problem.

Chairman GIBBONS. Let me point out, and I appreciate your coming, and I sure hope I do not run you off by lecturing to you—my wife tells me I have a tendency to do that, so it comes from the highest source, and I want you to know I am sensitive to it.

But you know, my green peppers are penetrated to the extent of about 75 percent, my strawberries to about 50 percent, my tomatoes to about 50 percent. They are small. My pimentoes to a very high percentage. My orange juice to 35 percent now coming in from Brazil. I have lost a large share of the world's phosphate market because of competitive advantages and disadvantages that are natural all over the place.

I want to give you one ray of hope, though, but it is not going to be too much. While last year, in 1982, U.S. auto imports increased by 2.6 percent, the Japanese auto imports into the United States decreased by 5.7 percent, so the voluntary agreement is doing some good.

As Mr. Bergsten pointed out, though, it is probably the best thing that ever happened to Nissen and Toyota. They both got rich off of it. They are much stronger companies today because of the auto import voluntary agreement than they were when they went into it. So, when they come out of it, they are going to be that much more competitive. It is going to be tough to compete with them.

I do not want to disclose conversations I have had with automobile leaders in my office, because I think that would be inappropriate, but I almost feel sorry for them, because they are not able to compete. They just do not have the managerial ability to compete right now. It is sad.

Now, there are two very sick industries in the United States. One is steel, and the other is automobiles. I read very thoroughly all the material that the Steel Caucus puts out. I am a member of the Steel Caucus, and I probably read the material as closely as anyone in the whole Steel Caucus. I hope that if you are a member of the Steel Caucus, or you have the material they sent out last week, you will take it and read it, all of you, because I am guilty of an error of statement.

I have been saying in this committee that steel wages are 70 some percent higher than the average industrial wage in the United States. The cost of hiring a steel worker and putting him to work is 70 percent higher than it is in other industrial jobs in the United States.

I am wrong. I have been making a misstatement. You know what the Steel Caucus tells me those wages are now compared to the rest of American industrial workers? Would you like to hazard a guess? Would anybody in the room like to hazard a guess? I have been so wrong.

Mr. **Frenzel**. A hundred percent.

Chairman **Gibbons**. A hundred and 14 percent in 1982, when steel workers were going out of work all over the United States. Steel workers in the United States were costing 114 percent premium over every other industrial job. This is not a new trend. This is a trend that began right after World War II, when we had to baby them to keep them operating in steel as the rest of us fought. They came out with a 15-percent premium. Now they are up to a 114-percent premium.

We cannot afford the United States steel industry. Nobody can afford them. They cannot afford themselves. You know, I have been hearing all these stories about how the imports of steel are tearing this market apart. Steel imports are about the same in the United States today in tons as they were in 1968.

They have stayed about the same since 1968, while the American steel industry has screamed and hollered at this Congress, and we have taken that abuse. It is not that there is that much more additional steel coming in here, even though this market has grown by a substantial amount in that time. It is the domestic market, because of prices, the service is so lousy, and the many mills have taken over a lot of the steel production in the United States, now 25 percent of all steel production in the United States.

Those jobs just disappeared, and yet wages are now 114 percent higher than the average American industrial wage. These are not my figures. These are U.S. Congress Steel Caucus figures.

So, we have a sick industry in steel, and the perception of it is horrible here, because I think the average Member of Congress would think, you know, we have just done the steel industry in. We have not done them in. They have done themselves in by their poor management practices, and their greedy practices that began in World War II.

I had to fight World War II, and they had to beg the steel workers and the steel factories to keep going here. They started giving them a premium of wages then, and it never has stopped. I am sick and tired of it, and I am going to Pittsburgh next week and tell them that.

Mr. **Frenzel**. They will be thrilled.

Mr. **Gephardt**. I am glad I am not going with you.

Chairman GIBBONS. I got invited this time. I have been there a couple of times before, but I got invited this time.

Well, Dick, you are one of the brightest Members of Congress, and one of the brightest members of this committee, certainly. We appreciate your coming here and working with us. I wish you were on this subcommittee, because we need your intelligence and your ability to help us out of these problems. We do need a better policy. We need to execute the policy we have in a better way.

The Japanese' hands are not clean, and we are going to look very strongly at their targeting practices and some of their other practices, their monopolistic practices that they have in products.

Yes, they have political problems, and we have political problems. We have got to solve them, though.

I appreciate your coming.

Mr. GEPHARDT. As I said, I think that your committee is in the cockpit in one of the most difficult if not the most difficult area we face politically in the country today. I know little of the answers, but I can tell you that I will look forward to working with you and giving you the benefit of anything, any idea that I have that might help the cause, and I appreciate what you are trying to do.

Chairman GIBBONS. Well, I need your help, because the only kind of politics I am an expert in is how I won the last election. I am not real sure I understand that, either.

Mr. GEPHARDT. That is the only kind that counts.

Chairman GIBBONS. Thank you very much.

By the way, we do not have a copy of your statement. If you have a formal copy, we would appreciate it. Would you like it put in the record?

Mr. GEPHARDT. Yes.

Chairman GIBBONS. All right. After this statement we will then put your formal statement in the record, and I appreciate it very much.

[The prepared statement follows:]

STATEMENT OF HON. RICHARD A. GEPHARDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Chairman, I appreciate the opportunity to testify before your subcommittee. As you know, I recently returned from a trip to Japan, and came away with the realization that we in the United States do not really comprehend the nature of the world marketplace. We must finally accept that our domestic market, while it may be the biggest in the world, is not enough to sustain our economy. We need international trade. We need to export. About 1 in every 6 jobs now depends on exports.

There has been a general failure to look at the big picture. Sure, we have a staggering trade deficit with Japan. We also have a large trade surplus with the European Community. It is both foolish and unrealistic to expect or demand that the United States have completely balanced trade with any one country. Until recently our current account balance was positive. (1982). Until recently, the Japanese current account balance was negative (1982). While we have had a huge trade deficit in our merchandise trade, we have had a surplus in trade in services. Over 60 percent or our workforce is employed in the service sector.

These are well known facts to those of us in this room. Not too many others are aware of them, however.

We should also recognize the pitfalls in protectionism. There is a good example of this in St. Louis. The industrial fastener industry, those people who make nuts and bolts, are being priced out of the market, and the only reason that they can't compete is because they have to pay more for steel that their competitors in Korea and elsewhere do. Excessive union demands are not the problem—steel import quotas that raise the price of steel in the United States are. Trying to save jobs in the steel industry loses them elsewhere.

I am also worried by what seems to be an increasing tendency for us to use our trade problems as a scapegoat for other problems. I would not deny that our huge trade deficit with Japan is a serious problem that we must address, but we can not blame all of our economic ills on the Japanese. I think that the growing anti-Japanese attitudes are indicative of this trend. (Do you want to relate Brice Story?) We need to develop constructive measures, not assign blame.

There is a great need for more education concerning this issue. Members need to educate their constituents. More important, those people who are committed to free trade, and here I am referring to the Administration, should spend more time educating Members of Congress. The U.S. Trade Representative should be here to talk to us, and so should the International Trade Administration. Not enough effort is being placed in this area.

Perhaps the most glaring flaw in our trade posture is the lack of a strategy. Not only does the Administration lack a working strategy for explaining its policies to Congress and the American people, but when I was in Japan, one of the most common questions I was asked was "What is it that your Administration wants from us?" How can we possibly expect to realize any results from our negotiations with the Japanese if we fail to present a coherent and comprehensive list of our demands? We have too many parts of our government trying to solve these issues, and they are working at cross purposes. Who makes our trade policy? We are confusing the Japanese and our other trading partners by speaking with conflicting voices.

There is general lack of direction. Why do we emphasize restrictions on beef and oranges in our dicussions with Japan? These are the most politically sensitive issues for Japan, and even if we were to get unlimited access for beef and oranges, this would make little significant difference in our overall trade balance. What should our priorities be? Now, they appear to be to make demands on our trading partners that are both impossible and meaningless. This must change.

To make any progress on this issue, we must make some important changes.

1. We need to look closely at the way our trade policy is created and organized. Perhaps a new organizational form is needed. Certainly, changes must be made so that we will make clear and specific requests. There must be a coordinated trade policy, and our demands should be realistic and meaningful. We need more quiet diplomacy and consultation with our trading partners, and fewer threats.

2. Voluntary agreements are good, short term solutions to big problems. I think that the renewal of the voluntary import quotas by the Japanese is a positive move, but it is only temporary. We can not just hope to keep extending this sort of agreement indefinitely.

3. I am particularly glad that this subcommittee has chosen to make the dollar-yen exchange rate one of the principle focuses of these hearings. This is a long term solution to our problems, and one that is very important. We do not usually consider the international ramifications of our domestic economic policy, and we should, especially now that we are beginning to realize how important international trade is to our economy.

4. We must look carefully at the question and role of export subsidies. Particulary, do we want to become involved in an escalating export subsidy "price war"? While other countries tend to make greater use of export subsidies as an export stimulant, we should carefully consider what our policy should be before we follow suit. Will we be willing to make the expenditures necessary to match our trading competitors? This question must be answered before we take any further action. The Administration has been threatening to match the subsidies of other countries—but is the President ready to take on this addition to our already huge deficits?

5. Finally, I would be remiss were I to fail to mention the role played by such protectionist legislation as domestic content. As I am sure that you all know, I am an original cosponsor of this bill. I do not consider it contradictory for me to sit here and call for free trade at the same time that I am a cosponsor of the domestic content bill. The domestic content bill is not my first choice, but if what I have outlined here does not happen, then the domestic content bill will pass again. I will vote for that bill because I am unwilling to accept the present situation.

We must force both the Administration and the Japanese to change. We must remember that the domestic content bill is a symptom of the problem that we are now facing. It is a very real problem and we will ignore it at our own risk.

Thank you Mr. Chairman.

Chairman GIBBONS. All right. Our next witness is going to be from the Business Roundtable and Caterpillar Tractor Co. Mr. Donald V. Fites, who is vice president of Caterpillar Tractor Co. We appreciate your coming up.

Mr. Fites, you may proceed as you wish.

STATEMENT OF DONALD V. FITES, VICE PRESIDENT, CATERPILLAR TRACTOR CO., ON BEHALF OF THE BUSINESS ROUNDTABLE

Mr. FITES. Good afternoon, Mr. Chairman.

Thank you for allowing me the opportunity to discuss the yen-dollar problem.

I do have a prepared statement, but I would like to deviate from that a bit to respond to some of the things that have been said here this morning.

Chairman GIBBONS. We would appreciate your doing that. We will put your prepared statement in the record at the end of your remarks.

Mr. FITES. Particularly as we move along here, I would like to respond to some of the things that were said about the United States being a safe haven, the effect of the valuation of the dollar on inflation and perhaps the domestic content law.

I am here on behalf of the Business Roundtable. As you know, the Roundtable has for months been urging the United States to take corrective action designed to address the yen-dollar imbalance, and we certainly commend the subcommittee for its high level of interest in this matter.

Our chairman, Lee Morgan, the Caterpillar chairman, presented a statement to this subcommittee in December, and he called for a commitment from U.S. policymakers to actively pursue remedies to the imbalance in the yen-dollar relationship, so that American companies can compete fairly against their Japanese counterparts in all world markets.

This morning, I would like to renew that call for action by the United States and Japanese Governments. I guess I should say this afternoon.

Chairman GIBBONS. It has been a long day, and it is going to be longer.

Mr. FITES. And offer what we believe to be some constructive suggestions on how to proceed. We have talked to you about the problem previously. This morning we want to talk about some suggestions on how to proceed. It could be, if we follow these, we will not need the national content laws. We will not need the escalated involvement of Government in R&D, and perhaps we can avoid the political crisis that was referred to by the previous witness.

In asking for action, I would like to remind the United States and Japanese policymakers that many Japanese businessmen are expressing exactly the same concerns about this problem as we are. I would like to read into the record an excerpt from a speech recently made by Isamu Yamashita, who is chairman of Mitsui Engineering & Shipbuilding Co., one of the very large, old-line companies in Japan.

I want to quote to you. He said:

Looking back at the past year, I think we can say that without question, one of the most serious problems in Japan has been the misalignment of the dollar and the yen. The undervalued yen added fuel to the flames of international resentment against Japan, worsening our trade relations with the United States and increasing protectionist sentiments.

As a businessman, I know that a cheap yen and high dollar are bad for the Japanese international trading position, and I am deeply, deeply concerned about this problem.

Mr. Yamashita continued:

This is one reason why we support continued steps to internationalize the yen. It is also important for the United States to take macroeconomic policies that take into account the competitiveness of the U.S. economy in world markets. In a longer run sense, both our governments need to review the operation of the international monetary and financial systems and to try to explore imaginatively ways and means of designing a system beneficial to trade which will help stabilize capital movements and prevent windfalls to financial speculators.

The main point is that neither country can correct the present misalignment alone. Both must take steps.

Let me repeat some of Mr. Yamashita's key phrases. "One of our most serious problems." "Added fuel to the flames of international resentment against Japan." "I am deeply concerned." "The yen is not fully internationalized" "We support continued steps to internationalize the yen." "The main point is that neither country can correct the present misalignment alone. Both must take steps."

I was interested in your questioning of Mr. Bergsten when you pressed him as to what he felt the most critical problem was in the Japanese-American trade relations, and he singled out the yen-dollar relationship as being the most critical, just as Mr. Yamashita has here in the statement I have read into the record.

The points that Mr. Yamashita raised are precisely the points that U.S. businessmen have been making, and now we would like to see our Government take some initiatives to correct the problem.

First of all, we should acknowledge, as pointed out here this morning, that in absolute terms from its weakest point in November of 278 yen to the dollar, the yen has strengthened to its present level of 235 to the dollar. However, if we view this over the perspective of the last 4 years in real terms, adjusted for differences in inflation, the yen is still 35 percent weaker than it was in 1978. And Japan has had 4 blockbuster years compared to the rest of the world.

During the last four quarters for which full information is available, Japan's exports of goods and services in constant yen grew at a 4.9-percent rate while those of the United States, France, United Kingdom, and Germany declined at rates of from 6 to 13 percent, a striking difference.

During the same four quarters Japan experienced a real gross national product growth in constant yen of 4 percent —incidentally, this is through the third quarter of 1982, the four quarters I am referring to—while the United States and other industrial countries experienced either negative or virtually no growth in real GNP.

I think these facts argue rather conclusively that the problem cannot continue to be brushed aside, as it has by some, as the strength of the U.S. dollar. Rather, the facts point to the weakness of the Japanese yen.

Japanese export performance continues to be relatively strong at the expense of other industrial nations. It has been estimated that the $75 billion to $100 billion U.S. trade deficit projected for this year translates into 2 to 3 million lost job opportunities, or said another way, potentially adds 2 to 3 percent to the U.S. unemployment rate.

That is the flip side to what Mr. Bergsten was talking about this morning. There may be a transitory gain in lowering the U.S. inflation rate by 1 or 2 percent, but when you are looking at a $75 to $100 billion trade deficit, you are looking at lost job opportunities which may hold unemployment up by 2 to 3 percent.

In the last 3 months since your last hearings on this topic, we have made a more detailed review of what actions could be taken to correct the yen-dollar imbalance. I will not say there is complete consensus in the business community, but there certainly are some general themes and specific recommendations that are emerging, and I would like to summarize those for you.

First of all, many analysts agree that the appropriate yen-dollar exchange rate should today be no weaker than 200 yen to the dollar. This figure represents a basic structural equilibrium rate around which short-term cyclical variations could occur. Certainly there have been variations in the past year, but at a significantly higher base than 200 to the dollar.

The interest rate spread between the United States and Japan is a major factor affecting the relative valuation of the currencies. There is general agreement that while Japanese savings propensities, which were mentioned here this morning, are an important contributor to the differential, conscious insulation of the yen from worldwide interest rate trends exaggerates the spread. We will talk about how that conscious insulation takes place.

Thus, we recommend policies in both countries to reduce the interest rate differential. In the United States the reduction of real interest rates must continue to receive priority attention. This will require firm control over the growth of the U.S. budget and deficit that was also discussed here earlier this morning.

But to complement our domestic efforts, the United States should insist that Japan allow its interest rates to be set by market forces and that induced short-term raising of Japanese interest rates is not sufficient. The basic factors that underlie the interest rate distortion need to be addressed.

Highest priority then should be given to the liberalization of Japanese financial and capital markets, and especially the encouragement of capital inflows. This much-touted reduction of Japanese capital flow barriers has been one sided. Capital now flows out of Japan much more freely than it did in the past, but there has been no commensurate increase in capital inflows.

This one-sided adjustment in capital flows is a major contributor to the yen-dollar exchange rate imbalance. Restraints on the flow of yen need to be removed. Ultimately, there should be a complete internationalization of the yen financial markets.

Japanese actions directed toward this goal should include then—I would like to briefly state eight points: No. 1, elimination of the yen interest rate ceilings on loans and deposits in Japan; No. 2, removal of restraints on the issuance of yen bonds on short-term yen-denominated bank borrowing by foreign investors.

We talk about the United States being a safe haven. One should ask why is Japan not a safe haven for funds flowing in. The reason they are not a safe haven is there is not a menu of financial instruments for investment in Japan at market rates. Therefore, that safe haven money does not have the alternative of flowing to Japan.

We are suggesting some things here that would take some of the pressure off the United States as being the sole safe haven. No. 3, increasing the limits on certificates of deposits deposited in yen; No. 4, establishment of a Treasury bill market in yen open to foreign investors; No. 5, allow importers to finance in yen rather than having to borrow dollars to pay for imports. Ninety-five percent of Japan's imports are invoiced in dollars. Seventy percent of their exports are invoiced in dollars. That is a tremendous demand for dollars to keep the Japanese trade machinery going, which elevates the value of the dollar. The demand for the dollar is higher.

No. 6, allowing other governments to hold more of their reserves in yen. I think today it has been stated here that in examining foreign reserves, only 4 percent of foreign reserves held by governments are now held in yen, about 12 percent in deutschmarks, and about 75 percent in dollars—another heavy demand on dollars.

No. 7, undertaking aggressive foreign borrowing with the proceeds converted to yen. No. 8, and finally, allowing purchase of yen in the foreign exchange markets without restrictions.

Concurrently, then, talking about these eight points which address the longer term, Japan needs to take steps to liberalize foreign direct investment. The government's screening and approval process remains a major obstacle to foreign direct investment. Restrictions on stock purchases make it virtually impossible for a foreign entity to acquire a Japanese company. There are limits on the percent of shares that foreigners can hold in Japanese companies. So liberalization of the investment policy would accomplish one of the major obligations we feel that Japan has to its world trading partners, and that is to operate in open, free, and fair trade and investment environment.

Most of these actions I have discussed are aimed at achieving an appropriate long-term equilibrium in the yen-dollar relationship, but we think there needs to be some short-term action as well, because in the view of many of us, the problem is critical to our short-term economic vitality. Thus, we would propose the following four short-term actions.

No. 1, let us declare it a problem. The imbalance in the yen-dollar relationship is, in the view of Japanese and American businessmen, causing economic and political problems for both sides. A simple joint declaration by the United States and Japan that the governments intend to undertake a joint program to bring the exchange rate to an appropriate level would help strengthen the yen relative to the dollar. That might do more than any of the other actions that I am suggesting here.

Chairman GIBBONS. Could you repeat that again?

Mr. FITES. Declare it a problem. Declare that a problem exists between the yen-dollar relationship today. A joint declaration by the

United States and Japanese Governments that the currencies are out of balance and that the two Governments intend to cooperate to bring them back into balance.

Chairman GIBBONS. Do you think we could get our Government to do that?

Mr. FITES. I was not present at the meeting.

Chairman GIBBONS. I know you were not, but maybe you found out through the grapevine some way and could tell us what the decision was.

Mr. FITES. Well, I think there was general acknowledgement, as I understand it, at the meeting that we do have an imbalance between the yen and the dollar, I think with some reservations by the Secretary of the Treasury.

Chairman GIBBONS. We are not going to Japan to bargain with the Japanese or negotiate with them. We are going to try to understand their system a little better, and I thought some of the points that you are making are excellent points. They are points that I have not heard before. That is the reason why I interrupted, because I think you are on target.

Mr. FITES. We think we are, too. Second, we think that we should undertake joint intervention in support of the yen. The United States could convert more reserves into yen. Japan could reduce permanently its huge dollar reserves. I think Mr. Bergsten touched on this this morning, that we do not view this as a long-term type of solution, but it is a catalyst to get the thing moving in the right direction. It is action that the United States has taken in the past when they felt that the dollar was too strong in relation to the yen. We intervened in the marketplace to try to reverse that situation. I am sure Japan did, too.

Third, for shock effect it may be necessary to impose a surcharge on Japanese goods. We believe this could be accomplished consistent with both countries' obligations under GATT. I do not have it here in my presentation, but you should be aware that the European Economic Community countries have filed a complaint under article 23 of the GATT virtually saying much of what I am saying in this testimony; that the yen—in certain respects a tightly controlled currency which has been insulated from the outside world, the yen does not play a role internationally commensurate with the strength of the Japanese economy. The unbalanced trade impact of the macroeconomic policies and protection of the yen is thus a matter of concern.

This goes on page after page. It is the representation by the European Community pursuant to article 23 of GATT filed on April 7, 1982. So again, I think this is evidence that we are not talking necessarily about the strength of the dollar. We are talking about a yen that internationally is weaker than it should be and gives the Japanese an unfair trade advantage. I think we are starting to see the Common Market move if not toward surcharges, toward some restrictions on Japanese imports by one source or another, France in particular.

Fourth, we believe that the United States should immediately request that the IMF look at Japanese exchange rate relationships. The IMF articles of agreement, call for a review of a country's policies that affect exchange rates where the exchange rates allow an unfair competitive advantage over other members. We believe the present situation demands such a review.

So those are four short-term measures. Let me repeat that we view these measures then as temporary. Hopefully, implementation of longer range measures discussed earlier would obviate the need for long-term intervention and surcharge programs.

I would like to finally touch on the question of whether the present international system that determines exchange rates is really working. Many people believe it does not. There is broad concern that capital movements are overwhelming the traditional role of trade flows in determining exchange rates.

Technically, you know, the present system should dictate exchanges rates that reflect the trade competitiveness of the trading partners, but that technical purity is destroyed by the kinds of trade and capital flow barriers that the Japanese maintain. So it seems appropriate that the United States seek to determine what kinds of modest or major adjustments need to be undertaken to assure that the exchange rate system works equitably.

So, in summary, Mr. Chairman, let me repeat three general themes that run throughout this presentation. The present system of exchange rates is not properly accounting for trade competitiveness. Its failures are influencing the protectionist sentiments that are growing in the world. This may require some strengthening of our international institutions like the GATT or IMF to deal with exchange rates more effectively. But whatever institutions we have, unless all nations play the trade and investment game fairly, there is no exchange rate system that is going to provide satisfactory results.

Second, the United States has a part to play in resolving this problem. U.S. domestic policy decisions must always take cognizance of the implications for our position in the international marketplace if we are really interested in trade.

Finally, a heavy burden, we feel, lies on the Japanese shoulders. They must either by their own initiative or by force of outside pressure take major steps to open their capital markets and internationalize their financial system so they do not shield it from the vagaries of the marketplace. The U.S. business community is fully prepared to undertake initiatives as needed to assert such pressure.

I thank you, Mr. Chairman, you and the subcommittee, for the attention that I am sure you will give to this set of recommendations. We believe the United States and Japanese Governments should be able to build on the framework we have set out here. We urge both Governments to do so.

I would be happy to answer any questions that you may have.

[The prepared statement follows:]

STATEMENT OF DONALD V. FITES, CATERPILLAR TRACTOR CO., ON BEHALF OF THE BUSINESS ROUNDTABLE

Good morning, Mr. Chairman, and thank you for allowing me the opportunity to discuss the yen/dollar problem.

I am here on behalf of the Business Roundtable. As you know, the Roundtable has for months been urging the United States to take corrective action designed to address the yen/dollar imbalance. I commend the subcommittee for its high level of interest in this matter.

Caterpillar Chairman Less Morgan presented a statement to this subcommittee in December. He called for a commitment from U.S. policymakers to actively pursue remedies to the imbalance in the yen/dollar relationship, so that American companies can compete fairly against their Japanese counterparts in world markets. This morning I would like to renew that call for action by the United States and Japanese governments, and offer what we believe to be some constructive suggestions on how to proceed.

In asking for action, I would remind United States and Japanese policymakers that many Japanese businessmen are expressing as much about this problem as we are. I'd like to read an excerpt from a speech recently made by Isamu Yamashita, Director and Chairman of Mitsui Engineering and Shipbuilding Co. He said:

"Looking back at the past year, I think we can say that without question one of our most serious problems in Japan has been the misalignment of the dollar and the yen . . . the undervalued yen added fuel to the flames of international resentment against Japan, worsening our trade relations with the United States and increasing protectionist sentiments. As a businessman, I know that a cheap yen and high dollar are bad for the Japanese international trading position, and I am deeply, deeply concerned about the problem.

"The reasons for this problem are complex, but the most obvious ones include high interest rates in the United States and the lack of investment opportunities in Japan, pulling capital out of Japan. Of course, all major currencies were affected by the same phenomenon, but the misalignment is more extreme in the case of the yen because the yen is not fully internationalized and more subject to speculative fluctuations.

"This is one reason why we support continued steps to internationalize the yen. It is also important for the United States to take macroeconomic policies that take into account the competitiveness of the U.S. economy in world markets. In a longer run sense, both our governments need to review the operation of the international monetary and financial systems and to try to explore imaginatively ways and means of designing a system beneficial to trade, which helps stabilize capital movements and prevents windfalls to financial speculators. The main point is that neither country can correct the present misalignment alone; both must take steps."

Let me repeat Mr. Yamashita's key phrases: "one of our most serious problems . . . added fuel to the flames of international resentment against Japan . . . I am deeply concerned . . . the yen is not fully internationalized . . . the main point is that neither country can correct the present misalignment alone; both must take steps." These are precisely the points that U.S. businessmen have been making. Now we'd like to see our government take some initiatives to correct the problem.

We should acknowledge here today that from its absolute weakest point last November of 278 to the dollar, the yen has strengthened to its present value of about 235 to the dollar. However, viewed over the perspective of the last 4 years, in real terms adjusted for differences in inflation, the yen is still 35 percent weaker than it was in 1978. During the last four quarters for which full economic information is available, Japan's exports of goods and services in constant yen grew at a 4.9 percent rate, while those of the United States, France, United Kingdom, and Germany declined at rates of from 6 to 13 percent—a striking difference. During the same four quarters, Japan experienced a real Gross National Product growth rate in constant yen of 4 percent, while the United States and other industrial countries experienced either negative or virtually no growth in real GNP.

These facts argue rather conclusively, in my opinion, that the problem cannot continue to be brushed aside as the strength of the U.S. dollar; rather, the facts point to the weakness of the Japanese yen. Japanese export industrial nations. It has been estimated that the $75 to $100 billion dollar U.S. trade deficit projected for 1983 translates into 2 to 3 million lost job opportunities, or, said another way, potentially adds 2 to 3 percent to the U.S. unemployment rate.

In the 3 months since your last hearings on this topic, we have made a more detailed review of what actions could be taken to help correct the yen/dollar imbalance. To say there is consensus in the business community on every detail of the proposed program would be an exaggeration. But some general themes and specific recommendations are clearly emerging in the debate, and I would like to summarize them for you.

Many analysts agree that the appropriate yen/dollar exchange rate should today be no weaker than 200 yen to the dollar. This figure represents a basic structural equilibrium rate around which short-term cyclical variations could occur. Variations have occurred in the yen/dollar rate in the past year, but they've been around a significantly higher base than 200/1.

The interest rate spread between the United States and Japan is a major factor affecting the relative valuation of the currencies. There is general agreement that while Japanese savings propensities are an important contributor to this differential, conscious insulation of the yen from worldwide interest rate trends exaggerates the spread.

Thus, we recommend policies in both countries to reduce that interest rate differential.

In the United States, the reduction of real interest rates must continue to receive high priority attention. This will require firm control over the growth of the U.S. budget and the deficit.

To complement our domestic efforts, the United States should insist that Japan allow its interest rates to be set by market forces. An induced, short-term raising of Japanese interest rates is not sufficient; the basic factors that underlie the interest rate distortion need to be addressed.

Highest priority should be given to liberalization of Japanese financial and capital markets and especially the encouragement of capital inflows. The much-touted reduction of Japanese capital flow barriers has been one-sided. Capital now flows out of Japan much more freely than it did in the past. But there has been no commensurate increase in capital inflows. This one-sided adjustment in capital flows is a major contributor to the yen/dollar exchange rate imbalance.

Restraints on the flow of yen need to be removed. Ultimately, there should be complete internationalization of yen financial markets. Japanese actions directed toward this goal should include:

1. Elimination of the yen interest rate ceilings on loans and deposits in Japan.
2. Removal of restraints on the issuance of yen bonds and on short-term yen-denominated bank borrowing by foreign investors.
3. Increase in the limits on certificates of deposit denominated in yen.
4. Establishment of treasury bill market in yen, open to foreign investors.
5. Allowing importers to finance in yen, rather than having to borrow dollars to pay for imports.
6. Allowing other governments to hold more of their reserves in yen.
7. Undertaking aggressive foreign borrowing, with the proceeds converted to yen.
8. Allowing purchase of yen in the forward exchange markets without restrictions.

Concurrently, Japan needs to take steps to liberalize foreign direct investment. The government's screening and approval process remains a major obstacle to foreign direct investment. Restrictions on stock purchases make it virtually impossible for a foreign entity to acquire a Japanese company. Liberalization of investment policy would accomplish one of the major obligations Japan has to its world trading partners; that is, to operate in an open, free, and fair trade and investment environment.

Most of the actions I've discussed are aimed at achieving an appropriate long-term equilibrium in the yen/dollar relationship. But there needs to be short-term action as well, because in the view of many of us, the problem is critical to our short-term economic vitality. Thus, we propose the following:

1. Declare it a problem! The imbalance in the yen/dollar relationship is, in the view of Japanese and American businessmen, causing economic and political problems for both sides. A simple joint declaration, by the United States and Japan, that the governments intend to undertake a joint program to bring the exchange rate to an appropriate level will help strengthen the yen relative to the dollar.
2. Undertake joint intervention in support of the yen. The United States could convert more reserves into yen; Japan could reduce permanently its large dollar reserves.
3. For "shock effect," it may be necessary to impose a surcharge on Japanese goods. We believe this can be accomplished consistent with both countries' obligations under the GATT.
4. We believe the United States should immediately request that the IMF look at Japanese exchange rate relationships. The IMF Articles of Agreement call for a review of a country's policies that affect exchages rates where the exchange rates allow an unfair competitive advantage over other members. We believe the present situation demands such a review.

Let me repeat that we view these measures as temporary and needed to provide immediate correction of a major problem. Hopefully, implementation of the longer range measures discussed earlier would obviate the need for long-term intervention and surcharge programs.

Finally, I'd like to address the question of whether the present international system that determines exchange rates really works properly. Many people believe it does not: that is, there is broad concern that capital movements are overwhelming the traditional role of trade flows in determining exchange rates.

Technically, the present system should dictate exchange rates that reflect the trade competitiveness of the trading partners. But the technical purity is destroyed by the kinds of trade and capital flow barriers that the Japanese maintain. So, it seems appropriate that the United States seek to determine what kinds of modest or major adjustments need to be undertaken, to assure that the exchange rate system works equitably.

Mr. Chairman, in summary, let me repeat three general themes that run throughout this presentation:

1. The present system of exchange rates is not properly accounting for trade competitiveness. Its failures are influencing the protectionist sentiments that are growing in the world. This may require some strengthening of our international institutions—like the GATT and IMF—to deal with exchange rates more effectively. But unless all nations play the trade and investment game fairly and equitably, there is no exchange rate system that will provide statisfactory results.

2. The United States has a part to play in resolving this problem. United States domestic policy decisions must take greater cognizance of the implications for our position in the international marketplace.

3. A heavy burden lies on the Japanese's shoulders. They must, either by their own initiative or by force of outside pressure, take major steps to open their capital markets and internationalize their financial system. The U.S. business community is fully prepared to undertake initiatives as needed to assert such pressure.

Mr. Chairman, I'll thank you and the subcommittee in advance for your attention to this set of recommendations I've just laid out. We believe the United States and Japanese governments should be able to build on the framework we've set out here. We urge both governments to do so.

Now, I'd be glad to answer any questions you might have.

Chairman GIBBONS. There would be, as I understand it, two impacts from what you advocated there. There would be a short-range impact and a long-range impact, and they may not be identical in effect. As I recall the testimony from previous witnesses, they said they were a little reluctant to push the Japanese to do much more to internationalize their currency right now because they thought the short-range impact would weaken the yen.

Do you feel the same way?

Mr. FITES. Some of the eight points I mentioned here that we feel are necessary to internationalize the yen would have an effect of weakening the yen. But we feel that the other points would more than overwhelm the shorter range points, so we are comfortable with that. We cannot have our cake and eat it, too, so to speak.

We recognize that one or two of those points, long-range points, would have that impact. That is why we also recommend a shorter term action which would have a more immediate effect of strengthening the yen.

Chairman GIBBONS. Well, I want to say your testimony is very helpful, and it raises a lot of new points on some of the things that we need to do. I will personally push the various levels of our Government to try to put this higher on the agenda, because I agree with you that it is probably the crucial trade problem that we have right now—the misvaluation of that currency.

Mr. Jenkins.

Mr. JENKINS. Thank you, Mr. Chairman.

Let me just pursue one area. You indicated there are a lot of things that we can try unilaterally in the exchange rate. Then if I understand you correctly, when you speak of a surcharge on Japanese products, then you are saying that we may have to resort to that if the exchange rate does not improve.

Is that basically what you are saying?

Mr. FITES. That is right, yes.

Mr. JENKINS. In other words, we would equalize the value, the exchange rate ourselves by the imposition of a surcharge if the Japanese Government fails to take action.

Mr. FITES. Yes. One could, for example, Mr. Jenkins, make that a sliding surcharge. If we felt the yen should be 200 to the dollar, the surcharge could decrease as the yen strengthened so that there would be some reason for the Japanese to want the yen to be strengthened.

Mr. JENKINS. Let me ask you one other question. On the interest rate situation in Japan, when we took the regulations, the controls and so forth off here as far as what banks could pay for deposits, what effect has that had on exchange rates?

Mr. FITES. I think it has probably attracted funds to the United States, but I believe the interest rate restraints that we are talking about in Japan are much more pervasive than the type of interest rates that we were talking about here in the United States.

So I think that there is not exactly a quid pro quo there. I think removing interest rate ceilings in Japan would have even a greater effect of strengthening the yen than perhaps it had in strengthening the dollar in the United States. It is a very pervasive thing.

One further comment. I have been asked a couple of times, why would the Japanese want to follow your advice. They are a sovereign nation, and you are telling them how to handle their interest rates.

I think it is clear that the Japanese have by far the most to lose if we lurch toward a trade confrontation. A study recently done by the OECD, a massive study that took 5 years to complete at the request of the Government of Japan, indicated that Japan, of all the major trade areas, will be by far the biggest loser if we do have a trade war.

Incidentally, the study also indicated of all the 13 trade areas, the United States would have the least to lose from that. So I think this is why Japan may be persuaded to take these actions, which are basically internal actions, in order to strengthen the yen.

Mr. JENKINS. There is nothing really punitive about imposing a surcharge if in fact there is an imbalance in the exchange rates.

Mr. FITES. I agree, and I think you will get a very broad consensus even among Japanese economists and businessmen that an imbalance does exist today. So I agree it would not be punitive in that regard.

Mr. JENKINS. Let me finalize by one further question. You indicated that USTR and Commerce have been in basic agreement, but there has been some disagreement from Treasury.

Mr. FITES. Yes.

Mr. JENKINS. What is the basis of their disagreement?

Mr. FITES. I have read Under Secretary Sprinkel's testimony before this committee, and if I understand his testimony, he believes that we should let the marketplace prevail in setting the exchange rates.

Mr. JENKINS. Even with a captive exchange?

Mr. FITES. I think that is the point that you will find the rest of the community making, including Commerce, USTR, and business: that you cannot have a marketplace unless you have free a marketplace. If there is no free market, you cannot let the marketplace set the rates. We would say there is no marketplace. There is no free marketplace for the dollar-yen exchange rate to be set today because of all the pervasive capital controls, interest controls that prevail in Japan today.

Mr. **Jenkins**. Thank you very much.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you very much for your testimony. We appreciate it.

Your company has done a splendid job in trying to help us understand these difficulties. You take what I would call a very aggressive European position. My judgment, like that of the Treasury's, is that there is still a good deal that we do not know about the subject. One of the things that disturbed me was that you said well, maybe we ought to have some kind of a surtax. If we think the yen should be equal to 200, or we think 200 yen should be equal to a buck, then we should force that kind of relationship.

Should we be the unilateral judges of what the yen should be? Can we just decide today that despite what the market is telling us that the yen is worth 200, and we say to the Japanese, by golly, that is what it will be or we will put this excess tariff on?

What kind of system would that be if we tell all of the people that we do business with that we will unilaterally determine the value of their currency?

Mr. **Fites**. That is certainly not the most desirable system, and we certainly would prefer some of these other actions, like first of all declaring it a problem; second, making the yen a safe haven currency. But we also have, I think, the short-term vitality of many U.S. industries to think about. I do not find that personally any more offensive than saying you can only export 240,000 cars, or you have to have 30 percent or 40 percent national content.

Mr. **Frenzel**. I think it is exactly the same. That is my problem with it. I think it is a unilateral decision which would make us fair game for every country in the world to say hey, there are too many dollars in our currency; we hereby declare the value of the dollar to be worth *X*.

I think it is fairly strong medicine based on the information that we have available to us about the relationship.

One of the things that you did not mention is the deficit in Japan. Do you notice how that has been growing? It is larger than ours. Does that have something to do with the value of the yen?

Mr. **Fites**. You are talking about the deficit as a percentage of GNP?

Mr. **Frenzel**. Yes.

Mr. **Fites**. Yes, it is larger than our deficit, but it is not being financed by printing money. It is being financed by the, I think as someone else pointed out here this morning, by the propensity to save.

Mr. **Frenzel**. It is also being financed by savings rates five times larger than our own. Would that have something to do with it?

Mr. **Fites**. I believe it would.

Mr. **Frenzel**. I must agree with you that the yen seems undervalued to me, yet the agencies that we have sent out to look into the problem are not finding a whole heck of a lot of manipulation.

Suppose the Japanese had come to us 5 years ago and said your interest rate ceilings are offensive to our relations. Don't you suppose we would have told them to stick it in their ear?

Mr. FITES. I think we probably would have, but I think we have to look at whose ox is getting gored here, and in this case it is the United States. I think we have every right and duty to somehow feel that we are competing in world trade on a fair basis. I think there is a general consensus that we are not competing on a fair basis today. There is a general consensus that the yen is undervalued on both sides of the Pacific.

So what we are trying to do is suggest some things that would bring that currency into better alinement.

Mr. FRENZEL. Well, we appreciate the suggestions. I would certainly agree that you are helping us shed some light on the problem. I yield the balance of my time.

Oh, I want to ask one other question. You know, we come over here and we come into the Congress and first we had the voluntary automobile restraints, which I think most people would agree we forced on the Japanese.

Then we have domestic content. We passed it in the House, we waved it up there as a threat. What do you think that does to the value of the yen? It sort of imperils the Japanese market in the United States, and it seems to me if I were in the business of buying currency, I would tend to buy fewer yen and more other currencies. If the United States kept saying to Japan, we are going to restrict our markets, doesn't that have some effect on the value of the yen?

Mr. FITES. I think you have to look at trade in a broader perspective. If we are just looking at the competitiveness of the marketplace, it would seem to me that the psychology of it is a tendency to strengthen the yen. This is saying Japan is so competitive we cannot compete. We have to put up these barriers. So it depends on how one's psychology works on that.

Mr. FRENZEL. Thank you.

Chairman GIBBONS. I am afraid that the Business Roundtable, as important as the Business Roundtable is, just to even suggest we should put a surcharge on would probably have some impact on the yen, and it will not be a very favorable impact. But you are right, it is one of the options we have. If we have to do something, it is probably a better option than domestic content or some silly legislation like that.

Mr. FITES. I think there are things we can do to avoid the surtax, which I mentioned here. That is really not the key point in what I suggested.

Chairman GIBBONS. I realize that. You have a lot of good suggestions there, and I recognize that you come from a very important segment of the American economy. Very important sector.

Mr. RUSSO. Can I ask whether you feel that the yen has been artificially weakened?

Mr. FITES. I do not endorse the word manipulated. That is a word that has been tossed around, and to me it is like looking for the smoking gun and someone sitting in the back room pulling the levers.

I think that the undervaluation of the yen is systemic. The system that we have talked about here, the system of controlled interest rates, the system of not allowing capital inflows in certain situations, the more recent encouragement of capital outflows, the system causes that to happen.

Then I think, Congressman, you have to ask yourself is this a contrived competitive advantage, or is this serendipity, that the whole system just happened to make Japanese products much more competitive.

Mr. Russo. It seems coincidental that you would have a tremendous liberalization in capital outflow at a time when you have a very restrictive policy on capital inflow. I would think that they would want to have more investment within their borders if they are going to allow so much to go out of their borders.

Mr. Fites. That would seem to be, but there are so many actual rules and regulations that do not encourage the capital inflows. I believe the fact that you do not have the access into Japan and that the Japanese do have the access to competitive world interest rates outside Japan—that as soon as they took the capital outflows off, money that piled up for years that Mr. Bergsten was talking about this morning fled the country to seek the higher interest rates. Much of it, I am sure, found it here and in Europe.

Mr. Russo. I take it in your suggestion of things you would want to do that your number one preference would be to declare it a problem and get both governments to step in and take some constructive action.

Mr. Fites. Right.

Mr. Russo. Do you think there is a chance to convince the Treasury that they ought to join in?

Mr. Fites. We are trying very hard.

Mr. Russo. It seems that you have Commerce and USTR on your side, which are two very powerful parts of this Government to admit that there is a problem.

Mr. Fites. I think we are making some progress with Treasury. I think there are still a couple of problems over there, but I think what we need to do there is convince Treasury that there is not a free marketplace for the yen-dollar relationships that exist today. Then I think we can probably get them to come along.

Mr. Russo. Mr. Bergsten this morning felt that in 6 months, the yen-dollar rate would go down to 200. Do you have the same kind of hope?

Mr. Fites. I am not as optimistic. We have seen the yen stalled now at about 235. We have seen that in both November, December, and January—and I do not have the February statistics yet—Japan is adding to their foreign reserves. They are adding at a rate above the implied interest rate on their foreign reserve holdings, which would indicate that they are accumulating dollars.

This, of course, will have the effect of holding the yen at a weaker level, so I am not as optimistic as Mr. Bergsten is unless we can cause some of these things that we have talked about here this morning to happen.

Mr. Russo. Thank you.

Mr. Jenkins. Mr. Chairman, could I ask one further question?

Chairman Gibbons. Yes, sir.

Mr. JENKINS. Is there any question in your mind but that the yen is, in fact, insulated?

Mr. FITES. Oh, it is insulated.

Mr. JENKINS. So what you are saying as far as the last resort surcharge is that we can take certain action unilaterally. But in order to avoid a trade war which could occur if we continue in the direction we are going, a surcharge would be a better alternative, would it not?

Mr. FITES. We believe it would.

Mr. JENKINS. You say in the event of a trade war, it would hurt everyone. But would Japan have more to lose and we would have less to lose?

Mr. FITES. According to this very massive study done by the OECD by far, Japan loses the most over the next 20 years if we launched into a trade war.

Mr. JENKINS. So while this Nation obviously cannot tell another nation what to do about the value of its currency, we can and should do something to prevent a continuous imbalance that is destroying domestic markets. Should we not?

Mr. FITES. Yes, we should. Surcharge is distasteful to all of us, but we have to find a way to get the attention, I believe, of the Japanese Government. If we cannot get it through a joint declaration, if we cannot get it through some changes in their internal policies, if they feel that is a violation of their sovereign rights, then I think we would be irresponsible to just let the thing continue to lurch.

Maybe one can draw an analogy to the action that has just been taken here on social security. We finally, because we could not let it go any longer, had to take some action, and some action was taken. I think trade is heading in the same direction. If we are going to let it just lurch along, eventually we are going to have to take some action that we probably could have taken earlier that would have been more tasteful.

Mr. JENKINS. I think you are absolutely correct. I think while it is wonderful to sit here and for us to believe in free trade when, in fact, this imbalance along with other matters is destroying the concept of free trade, I would like to learn of other alternatives if they are there. But I think that your suggestion is good as a last resort.

I thank you for your testimony.

Chairman GIBBONS. Thank you, sir.

Mr. FITES. Thank you, Mr. Chairman.

Chairman GIBBONS. Our next witness is from the semiconductor industry, Mr. Alexander Lidow, who is vice president, research and development, Semiconductor Division, International Rectifier Corp.

STATEMENT OF ALEXANDER LIDOW, VICE PRESIDENT, RESEARCH AND DEVELOPMENT, SEMICONDUCTOR DIVISION, INTERNATIONAL RECTIFIER CORP., ON BEHALF OF THE SEMICONDUCTOR INDUSTRY ASSOCIATION, ACCOMPANIED BY TOM HOWELL, SIA COUNSEL

Mr. LIDOW. Mr. Chairman, my name is Alexander Lidow. As you said, I am vice president of research and development of the Semiconductor Division of International Rectifier Corp., and I am here to testify on behalf of the Semiconductor Industry Association which represents a majority of the U.S. merchant and captive producers of semiconductors in matters of trade and Government policy.

I also have with me today Mr. Tom Howell, SIA counsel and principal contributor to a very cogent study on the effect of Government targeting on world semiconductor industry competition, which you have all received a copy of. This study has detailed data supporting most of the testimony that I am here to give today.

We understand that the purpose of these hearings is to help your committee prepare for the trip to Japan later this month. The SIA believes that there is one strong message the members of your delegation should convey to the Japanese. They should be more receptive to the purchase of competitive U.S. products, and in particular, U.S. semiconductors.

The fact that there is a need for such a message to be conveyed at all is not a reflection of an isolated trade barrier or competitive problem, but of an overall Japanese industrial policy; namely, targeting, which we feel represents the most serious challenge faced by our industry today.

In fact, it is not an exaggeration for me to state that the effects of Japanese targeting and the market distortion purposes which it entails are becoming so serious that they threaten this country's ability to grow and remain competitive in the high technology industries.

When you are in Japan you will see probably the most modern semiconductor plants that the Japanese have ever built. You will see them in Tokyo, you will see them on Kyushu Island. You can have confidence that the U.S. plants that exist are better, there are higher technology, cleaner, more automated plants for the manufacture of semiconductors in the United States.

But I would also like you to ask yourself what paid for those plants that you see on Kyushu Island and in Tokyo. In the United States, it was profits that paid for the plants, and we contend, and we substantiate it in this report, that it is not necessarily profits that paid for the plants in the Japanese semiconductor industry.

The Japanese targeting——

Chairman GIBBONS. Let me interrupt your statement. Do you have anything in your statement or anything in your backup that goes to how the Japanese plants were paid for?

Mr. LIDOW. Yes, we do. We have a detailed list of all the different types of subsidies, the loans, the bank loans. As a matter of fact, some of them are listed on the chart that you have right there.

Chairman GIBBONS. I just have a little trouble reading that chart.

Mr. LIDOW. It is attached to the testimony.

The Japanese targeting strategy is like an incubator where the first step is to protect the home markets through barriers to trade. The first chart shows you the U.S. share of the Japanese semiconductor market; that is the blue line down at the bottom. In green, we have all the various dramatic and widely touted liberalization measures of the Japanese Government throughout time. In orange above [illegible] are the Japanese countermeasures.

That is not a word that I coined, by the way. That is the word the Japanese used for the various measures that are illustrated there in orange.

The net effect is that the U.S. share of the Japanese semiconductor market for the last 10 years has remained flat. Another interesting point, in light of the other testimony given today, is that between 1976 and 1978, the value of the dollar with respect to the yen eroded by 44 percent, and you can see the electrifying 1 percent increase in our penetration of the Japanese market with a 44-percent change in our competitive advantage. This is, I think a pretty clear example of a nonmarket economy, and a pretty well-thought-out barrier to trade.

The Japanese purchase of products that you see on there are largely products not manufactured in Japan, so-called proprietary or leading edge technology, U.S. products. On the next chart, I show what happens to these U.S. products once the Japanese manufacture them themselves.

The 8080 microprocessor in the midseventies was absolutely the state of the art. It was invented by Intel Corp., and you can see on the top chart the demand for that product in the Japanese marketplace. It is experiencing a rather standard industry growth curve as it gains acceptance in the marketplace. The dollar volume of shipments increased. Then in about mid-1979 the Japanese—actually, NEC—started manufacturing in volume the same product. The orders did not fall just a little bit; they went below zero. That is represented by the red part on the chart there. Those are actually cancellations of existing orders.

This kind of precipitous drop could not be a simple free market force, especially the orchestrated cancellation of all of the orders.

I would like to point out that this is a representation of all the U.S. manufacturers. In other words, they all simultaneously saw this cancellation of their orders and that market disappeared. It never recovered. In contrast, the lower chart shows our world penetration of the 8080 microprocessor, showing a rather normal curve, peaking in 1979 and then declining as the product goes into obsolescence. No precipitous drop or completely going to zero.

Once the Japanese have achieved a suitable level of local demand and then proceed to put on excess manufacturing capability, they mount a rather devastating export drive, which is shown in the next chart. This is a chart which shows you the price per bit. A bit is the essential storage element of memory. It is represented by a single transistor in a dynamic RAM. The price per bit versus the volume of bits sold—this is a representation of the classic learning curve, which typically has a 70-percent slope, roughly. That means that every time you double your volume you achieve a 30-percent reduction in cost and, therefore, a 30 percent reduction in price.

In 1975 to 1980, there was quite a bit of ferment in the industry. Revolutionary technologies, entrance and exits from the competitive arena, and yet, it still fits fairly close to the 70-percent slope.

In 1980, a rather dramatic event occurred. The Japanese entered the market in force and rather than a 70-percent slope, the slope was 2½ times that rapid decline.

At the same time, on the next chart you can see that absolutely simultaneously the profit picture of U.S. manufacturers of dynamic RAM's went from the black to the red. I ask you, without profits how can we build those plants?

When you are in Japan we would like to ask that you request that the Japanese start buying U.S. high tech products at a rate exceeding the market growth. Recently, NEC widely touted the fact that they anticipate purchasing 20 percent more products from the United States in calendar 1983. In a separate report, they anticipate purchasing 25 percent more semiconductor components in total. Therefore, we are seeing an erosion of our position at NEC next year.

We really need an increase greater than their increase of purchasing of total components.

In conclusion, I would like to just state that because specific trade liberalization measures have all resulted in absolutely no progress, it is only affirmative action as measured in increasing purchases of product faster than the rate of growth of the market that can conceivably satisfy the requirements of the U.S. high technology industry.

Thank you very much.

[The prepared statement follows:]

Statement of Alexander Lidow, on Behalf of the Semiconductor Industry Association

Mr. Chairman, I am Alexander Lidow, Vice President, Research and Development, Semiconductor Division, International Rectifier Corporation. I am here to testify on behalf of the Semiconductor Industry Association, which represents the majority of U.S. merchant and captive producers of semiconductors in matters of trade and government policy.

We understand that the purpose of these hearings is to help your Committee prepare for your trip to Japan later this month. SIA believes that if there is one strong message the members of your delegation should convey to the Japanese, it is that they should be more receptive to the purchase of competitive U.S. products, and in particular, U.S. semiconductors. The fact that there is a need for such a message to be conveyed at all is not a reflection of an isolated trade barrier or competitive problem, but of an overall Japanese industrial policy—targeting—which represents the most serious challenge faced by our industry today. In fact, it is not an exaggeration for me to state that the effects of Japanese targeting, and the market distorting practices which it entails (including market protection) are becoming so serious that they threaten this country's ability to grow and remain competitive in the high technology industries.

THE PROBLEM OF JAPANESE INDUSTRIAL TARGETING

Targeting is a form of competitive hard ball under which the Japanese government identifies industrial sectors which it wishes to promote to a position of world competitive prominence, if not dominance, and takes a series of government-directed measures designed to ensure that result. Many of these measures distort free market competition and violate international agreements—but particularly when employed as part of a comprehensive promotional strategy, they have proven highly effective in placing Japanese firms in a position of international competitive advantage. I have submitted to your Committee a study prepared by the Semiconductor Industry Association, The Effect of Government Targeting on World Semiconductor Competition, which describes Japan's targeting of the semiconductor industry and the impact of that program on the U.S. industry.

As the study describes, in the mid-1970's the powerful Japanese Ministry of International Trade and Industry (MITI) set a long range economic goal for Japan—preeminence in the high technology industries. As in earlier targeting programs, MITI took a wide range of mutually-reinforcing promotional measures to ensure that Japanese industry attained that goal. MITI protected Japanese high technology firms from foreign imports and investment. MITI organized Japan's high technology industries—participating with them in setting industry-wide goals for research, development and production. MITI encouraged the formation of research cartels to avoid duplicative R&D and share costs and results. MITI provided numerous financial incentives, including grants for R&D, low-interest loans, tax breaks, and assistance in securing private-sector bank loans to its high technology firms.

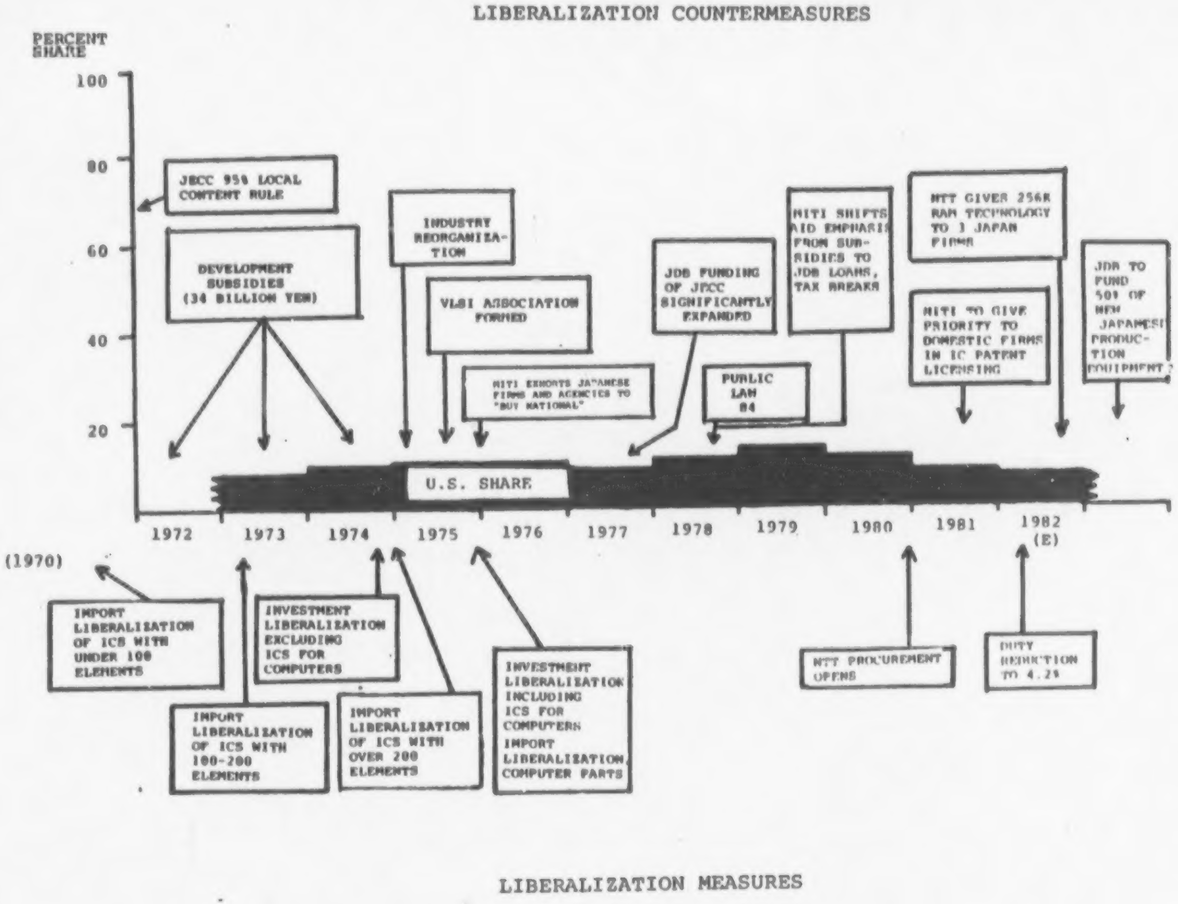
Because semiconductors are the basic building blocks of many other high technology sectors (telecommunications systems, robotics, computers), MITI's promotional effort initially placed a very heavy emphasis on semiconductor development—and we in the semiconductor industry have been among the first of the U.S. high technology industries to begin to feel the Japanese program's impact.

DOMESTIC MARKET PROTECTION

The SIA study describes how the Japanese government protected its "infant" semiconductor industry through the mid-1970's with quotas, restrictions on foreign investment, and other measures. At the same time it encouraged and assisted Japanese semiconductor firms to import U.S. technology. This permitted domestic semiconductor producers to establish production capabilities and a strong domestic market position at a time when the U.S. Industry enjoyed clear technological leadership.

Under U.S. pressure, Japan removed its formal semiconductor import and investment barriers in the mid-1970's. However, despite repeated major efforts by U.S. firms to expand their presence in Japan over a period of decades, U.S. sales today account for under 10 percent of Japanese domestic consumption—a smaller share than when the market was protected by formal quotas. In part, this reflects "countermeasures" undertaken by the Japanese government to offset the relaxation of formal barriers to the domestic market. The first chart I have with me shows the various "liberalization" measures Japan has taken over the past decade with respect to semiconductors. As can be seen, these measures have been offset by a series of liberalization "countermeasures"—a term which was coined by the Japanese, not myself. The net result has been a consistently negligible U.S. market share.

CHART ONE


LIBERALIZATION COUNTERMEASURES
PERCENT SHARE
100
80
60
40
20
JECC 95% LOCAL CONTENT RULE
DEVELOPMENT SUBSIDIES (34 BILLION YEN)
INDUSTRY REORGANIZATION
VLSI ASSOCIATION FORMED
MITI EXHORTS JAPANESE FIRMS AND AGENCIES TO "BUY NATIONAL"
JDB FUNDING OF JECC SIGNIFICANTLY EXPANDED
PUBLIC LAW 84
MITI SHIFTS AID EMPHASIS FROM SUBSIDIES TO JDB LOANS, TAX BREAKS
NTT GIVES 256K RAM TECHNOLOGY TO 3 JAPAN FIRMS
MITI TO GIVE PRIORITY TO DOMESTIC FIRMS IN IC PATENT LICENSING
JDB TO FUND 50% OF NEW JAPANESE PRODUCTION EQUIPMENT ?
U.S. SHARE
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982 (E)
(1970)
IMPORT LIBERALIZATION OF ICS WITH UNDER 100 ELEMENTS
IMPORT LIBERALIZATION OF ICS WITH 100-200 ELEMENTS
INVESTMENT LIBERALIZATION EXCLUDING ICS FOR COMPUTERS
IMPORT LIBERALIZATION OF ICS WITH OVER 200 ELEMENTS
INVESTMENT LIBERALIZATION INCLUDING ICS FOR COMPUTERS
IMPORT LIBERALIZATION, COMPUTER PARTS
NTT PROCUREMENT OPENS
DUTY REDUCTION TO 4.2%
LIBERALIZATION MEASURES

An additional barrier to U.S. firms is the Japanese market structure—the same firms that produce most of Japan's chips also account for most of its semiconductor consumption. They control most domestic demand, and have the incentive and the ability to resist imports—and a long history of doing so.

United States semiconductor firms selling their products in Japan have repeatedly found that when a Japanese product comparable to their own becomes available, their own sales fall off sharply, sometimes virtually to zero. An example of this is depicted in the second chart, which shows the experience of three U.S. firms selling 8080-type microprocessors in Japan. The top chart shows United States 8080 bookings in Japan, which were reasonably stable through mid-1979. Soon after Japanese firms were able to supply the whole Japanese market, however, U.S. firms' sales virtually disappeared (The negative figures reflect canceled bookings). Subsequent bookings have been virtually nil. This experience should be contrasted with the same three companies' experience in the world market (bottom chart) the same product during the same time frame. As you can see, in contrast to the experience in Japan, United States bookings tapered off gradually as the life cycle of the product came to an end.

A protected home market does more than simply deny sales to U.S. firms, although that is certainly a serious problem. Protection gives Japan the ability to nurture prospective growth sectors to the point where they can suddenly challenge U.S. high technology firms very aggressively in the world market. As a 1980 advertisement run by 16 Japanese firms in Scientific American observed; Protection has been provided those industries that are in need of protection because of their newness and their fragility as emerging industries. Thus, protection is negotiated for the semiconductor and computer industries, and telecommunications. . . . Sectors of high value added, and high technology, with high growth potential, are afforded as much protection as can be arranged.

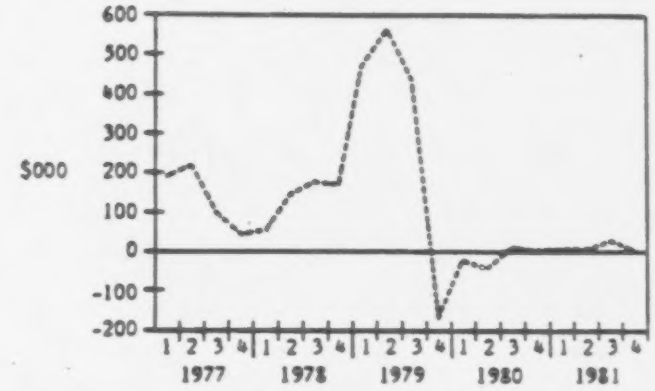
Protection in the home market has enabled Japanese semiconductor firms to develop a large sales volume for new products, achieving economies of scale and "learning" economies—cost savings which manufacturing firms learn to achieve as they produce more and more of a particular product. Ultimately, such protection has enabled Japanese firms to enter the world market with devices they have learned to make very cheaply.

Without domestic protection, we do not believe that Japanese targeting would be nearly as effective as it is—in fact, it might not work at all. That is why in our trade program we have stressed as our number one objective the complete opening of the Japanese semiconductor market to U.S. imports and investment.

The U.S. Government is currently conducting ongoing negotiations with Japan in the bilateral High Technology Working Group—a very important mechanism for addressing current high technology trade problems with Japan. We have asked the U.S. Government to inform Japan in the High Technology Working Group discussions that the United States expects to see a dramatic improvement in U.S. semiconductor sales in Japan by this summer—reflected in an increase in U.S. sales that is substantially greater than the increase in total sales in the Japanese market.

CHART TWO

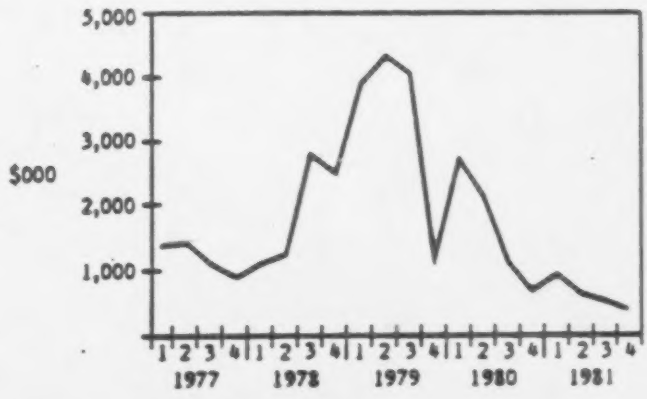
ESTIMATED UNITED STATES BOOKINGS OF 8080-TYPE MICROPROCESSORS TO JAPANESE MARKETS



Source: Company Estimates

Figure DD:

ESTIMATED UNITED STATES BOOKINGS OF 8080-TYPE MICROPROCESSORS TO WORLD MARKETS



Source: Company Estimates

THE JAPANESE EXPORT DRIVE

Domestic market protection was only one aspect of the Japanese targeting program. In addition, the government extended massive financial aid to the industry—subsidies, low interest loans, tax breaks, free or low cost R&D, access to government research personnel and facilities, and other aid. The industry was organized by the government into collaborative groups ("tieups"), exempt from the antitrust laws, to maximize scale economies and share research and development efforts.

In 1975-76, MITI launched a major industry-government collaborative R&D program designed to promote Japanese capabilities in very large scale integration (VLSI), one of the most complex and commercially significant semiconductor technologies. The VLSI Project was a "research cartel," partially funded by the government, featuring a collaborative division of R&D labor by the participating firms—Japan's leading semiconductor producers—and a sharing of the results among the various participants. This enabled each company to develop new technologies at a fraction of the cost incurred by U.S. firms, who must conduct their R&D independently. A major participant in this project was Nippon Telephone & Telegraph (NTT), Japan's government-owned telecommunications monopoly, which possesses the foremost electronics research laboratories in Japan, rendered major semiconductor R&D assistance to Japanese firms (this included use of NTT's personnel and facilities, and results of NTT research turned over to Japanese firms at low cost or free of charge.)

At the same time that the VLSI Project was under way, Japanese firms began a major buildup of semiconductor production capacity—focusing heavily on capacity needed to produce advanced VLSI devices, including the 16 kilobit and 64 kilobit random access memories (16K and 64K RAMs)—computer memory chips that enjoy widespread potential demand and which contribute to a producer's technological capability in virtually all other semiconductor product lines. The 64K RAM is the most advanced computer memory chip available on the market today, and is forecast to become the largest-selling semiconductor device in history. In the context of world semiconductor competition, RAMs represent the "high ground," and the Japanese were moving, with government help, to seize that high ground.

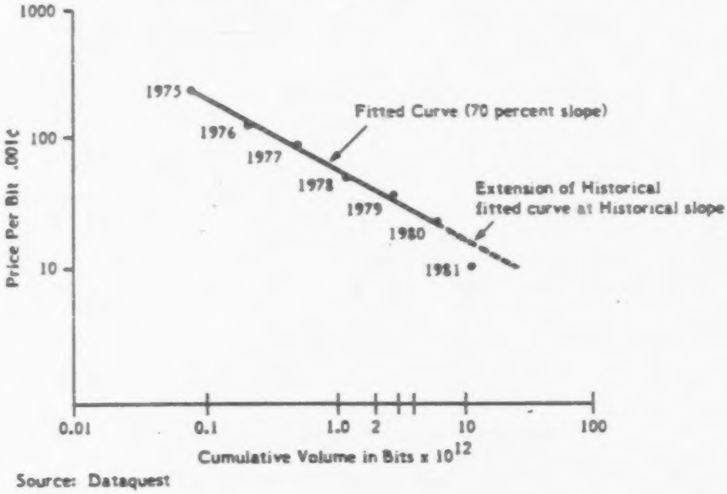
Japan began exporting large numbers of 16K RAMs in the late 1979's, and by early 1981, six Japanese companies were producing and exporting 64K RAMs. At that time, only three U.S. companies, proceeding on their own, were producing this advanced device, and one of these companies later withdrew its design. Japanese companies turned out 64K RAMs faster than the world market could absorb them, and Japanese companies led 64K RAM prices rapidly downward. In 1981, the price fell from $25-30 per unit to about $8 by year's end. By the end of 1981, Japanese firms had caputured 70 percent of the world market for this device.

The third chart I have with me shows that 1981 RAM prices, initiated by the Japanese were much lower than would have been predicted, given the consistent historical industry experience. The experience curve for the industry, depicted in the chart, has followed a consistent pattern for many years—the price per bit has declined at a predictable rate of 30 percent for each doubling of industry output. This rate of price decline has remained constant despite substantial competitive ferment in the industry—entry and exit of individual firms, next product generations, recessions and so on. Then in 1981, coincidentally with the Japanese 64K RAM export effort, the price fell 2½ times that fast—a break with precedent that is simply unprecedented. In this connection it is significant that one Japanese semiconductor executive has predicted that no one will be profitable at the projected mid 1983 64K RAM price of $5.00 per device.

CHART THREE

HISTORICAL DYNAMIC RAM PRICE PER BIT v. CUMULATIVE VOLUME IN BITS

Data Points Represent Industrywide Mid-Year Average Price
Per Bit and Year End Volume, All Generations of RAMs

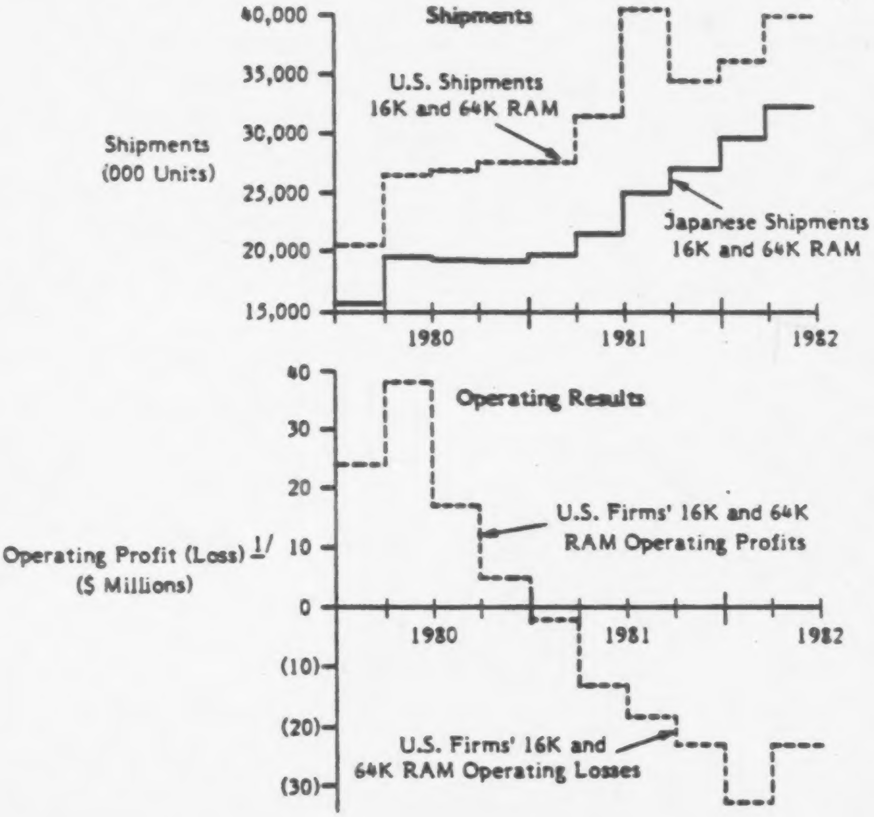


Source: Dataquest

This kind of pricing has hurt the U.S. industry. The fourth chart shows the impact of Japanese exports of 16K and 64K RAMs on five of the six leading U.S. producers. Between the first quarter of 1981 and the fourth quarter of 1982, these five producers suffered a cumulative net pre-tax operating loss of $148 million on these two product lines. The period of heaviest losses coincided with the budget volume of Japanese shipments. (The sixth producer has indicated that it too lost money on the 64K RAM in 1981 and 1982, so these losses are, if anything understated.) You will note that in this composite of 16K and 64K RAM results, the U.S. firms had more shipments than the Japanese. The bulk of the U.S. shipments, however, are accounted for by the 16K RAM—the older generation product. In 64 K RAMs, the later generation product, the Japanese outsold U.S. firms by more than 2 to 1 in 1981.

CHART FOUR

CUMULATIVE 16K AND 64K DYNAMIC RAM SHIPMENTS AND OPERATING RESULTS, 1980-1982



1/ Five U.S. firms' submissions composite net pre-tax operating results.

Moreover, the outlook is even more grim for the next generation product, the 256K RAM, which may be commercially introduced as early as this year. Individual U.S. firms must invest large sums—one estimate is $160 million—to commercialize the 256K RAM. Yet United States and Japanese firms have not recovered their investment in the prior generation product, the 64K RAM. In Japan, however, the government telephone monopoly, NTT, designed a 256K RAM and turned the technology over to four leading Japanese firms free of charge. Thus, the preeminent research laboratory in Japan is turning over state-of-the-art 256K RAM technology to Japan's preeminent semiconductor producers. Nothing comparable to this occurs in the United States. Japanese firms are now rushing to invest in 256K RAM production facilities, and two of these firms—Hitachi and Oki—have announced they will begin mass production of the 256K RAM in the second half of 1983.

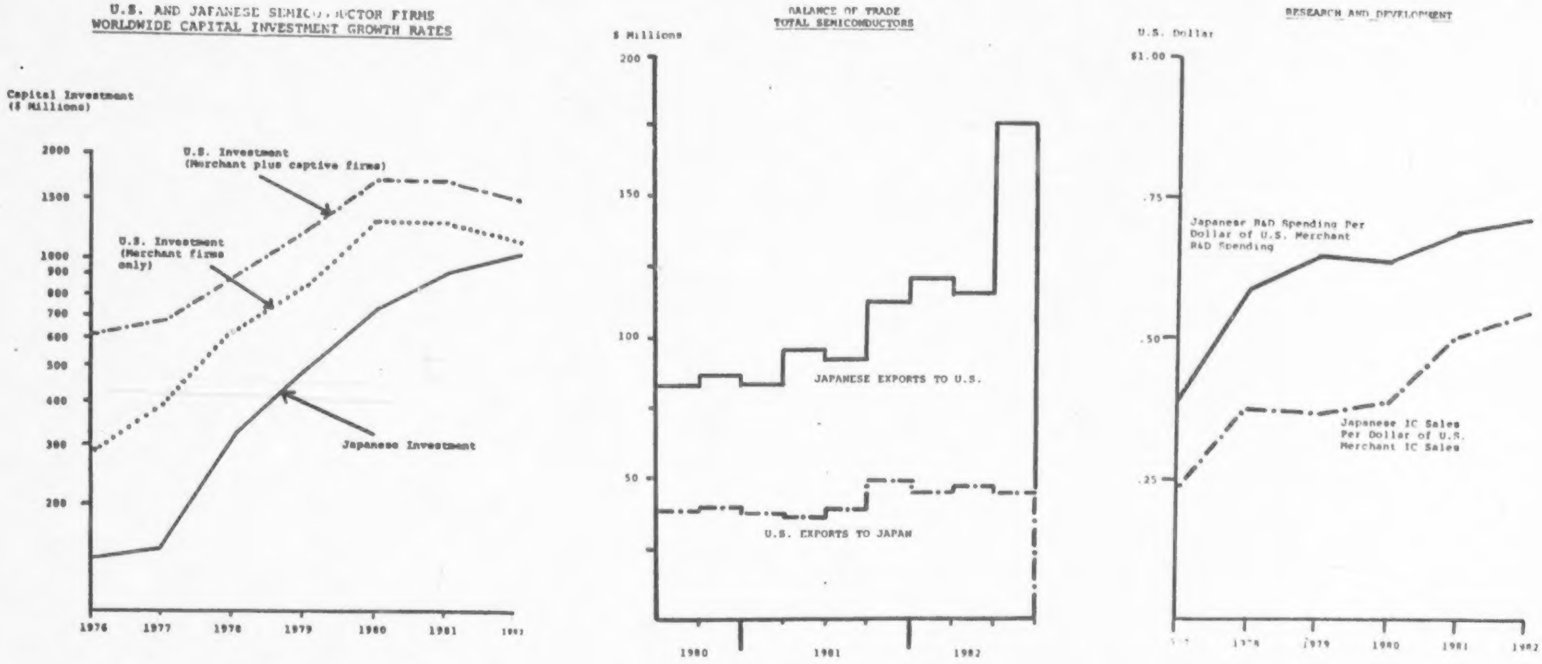
DETERRENT TO U.S. INVESTMENT

The impact of the 16K 64K RAM losses on U.S. firms has been serious—in effect they are a deterrent to further U.S. investment in the product areas the Japanese have chosen to dominate. Little incentive exists to invest in sectors at which the Japanese are taking collective "aim." Thus, U.S. semiconductor companies which produced earlier generations of RAMs are refraining from entering production of the 64K RAM. Whereas 12 U.S. companies at one time produced 16K RAMs, by mid-1982 only 5 were producing 64K RAMs, and of these, only 2 were in large scale production. While the increasing cost of RAM production and development may have deterred some of these firms, others have indicated that Japanese pricing has caused them to defer further investment in the 64K RAM. Moreover, while additional firms may enter the market, as one Japanese semiconductor executive commented, "the latecomers will be shaken out." The number of U.S. firms producing the next generation of RAMs, the 256K, may well be even less than at the 64K level.

The fifth chart I have with me shows how the competitive balance is rapidly beginning to tip against the U.S. semiconductor industry. The graph on the left indicates that while capital investment growth by U.S. semiconductor firms remained strong through 1980, it leveled off in 1981 and is actually declining in 1982. Meanwhile the Japanese are continuing to increase their level of capital investment and are now virtually matching U.S. merchant firms' investment dollar for dollar. The middle figures show that the United States-Japan balance of trade, both in semiconductors and integrated circuits, has been running heavily against the United States for the past 2 years, and has begun to deteriorate even more seriously in recent months, as reflected in the figures for the third quarter of 1982. In research and development U.S. firms are still outspending Japan, but Japanese firms are gaining fast, and because of the joint R&D projects, they are able to get more R&D per dollar invested. These charts demonstrate how quickly competitive reversals in high technology can occur.

CHART FIVE

U.S.-JAPAN COMPETITION IN SEMICONDUCTORS



THE NEED FOR AN EFFECTIVE RESPONSE

Targeting entails many promotional measures—market protection, subsidies, cartels, and other devices designed to give Japanese firms a competitive advantage over our own. These measures are particularly effective in high technology sectors because they reinforce several key elements of competitive success in those sectors—the ability to sustain a high level of expenditure on research and development and a high level of capital investment. The results are typically manifested in the form of sudden onslaughts of low-priced exports, and abrupt loss of sales by United States firms in Japan. In the end, the result has often been abandonment by United States firms of the targeted areas to the Japanese.

SIA believes that Japanese targeting practices violate U.S. rights under the General Agreement on Tariffs and Trade (GATT), and we have asked the U.S. Government to examine Japanese practices in light of Japan's obligations under the GATT. However, we feel that while Japanese targeting violates our GATT rights, we do not believe that the most effective response is to screen our market, but to press the Japanese to open their own market. In semiconductors, Japanese practices create a "pressure vessel"; in which surplus capacity its built up in a protected environment—and ultimately unleashed in the form of damaging export drives which undercut U.S. profitability and discourage further investment. Active participation by U.S. firms in the Japanese market—including access to government financing on the same terms as Japanese firms and participation in Japanese joint R&D programs—will "decompress" the pressure vessel and greatly diminish the prospect of sudden, damaging export drives from Japan.

To be sure, Japan has frequently asserted that its market is already open. We submit that given Japan's recent history of protectionism in this industry, and the low sales performance of United States firms in Japan as compared with their performance in the rest of the world, the Japanese market cannot be regarded as "open" until U.S. firms' sales as a percent of total sales in Japan show a very substantial increase. We have asked U.S. Government negotiators to press the Japanese Government on this point and to insist that U.S. sales, as a percent of total sales, show a substantial increase by this summer. If this does not occur, additional steps may be necessary.

CONCLUSION

This country simply cannot afford to see its high technology industries weakened or destroyed by foreign industrial policies. The high technology industries represent the most efficient, productive, and growth-oriented manufacturing sector of the U.S. economy—one which reinforces the economic health of all other manufacturing and service sectors. Continued U.S. strength in high technology is essential if we are to retain a strong economy, a high standard of living, and a solid export based through the remainder of this century. The challenge posed to our high technology industries by government targeting is, in effect, a challenge to our national economic well-being.

[The information referred to follows:]

SEMICONDUCTOR INDUSTRY ASSOCIATION
LEGISLATIVE PRIORITIES 1983

1. TRADE LEGISLATION

ISSUE: Current U.S. trade laws are inadequate to address the harmful effects of foreign government targeting practices in high technology.

STATUS: On January 25, 1983, Sen. Danforth re-introduced a bill which incorporated high technology trade legislation backed by SIA in 1982.

POSITION: SIA supports passage of this and other legislation that will enable the U.S. government to deal more effectively with foreign market distorting practices.

2. EXPORT CONTROLS

ISSUE: The Export Administration Act of 1979 expires this fall and will be subject to renewal.

STATUS: New legislation will be proposed which would severely tighten U.S. export controls.

POSITION: SIA, while supporting measures to strengthen national security, opposes measures which would unnecessarily restrict exports and raise costs. SIA also supports a system of controlling technology transfer through implementation of a comprehensive operations license which recognized and utilized the mechanisms U.S. firms use to protect proprietary and business information.

3. R&D TAX CREDIT

ISSUE: U.S. firms are allowed a 25 percent tax credit for R&D expenditures which exceed prior years' levels.

STATUS: The credit is scheduled to terminate in 1985 and some members of Congress may seek to repeal it this year.

POSITION: SIA supports expansion of the R&D credit and its extension beyond 1985. SIA also proposes a zero based credit for corporate support for university research and education.

4. COPYRIGHT PROTECTION

ISSUE: U.S. copyright and patent laws do not clearly protect semiconductor circuit designs.

STATUS: Senator Hart and Rep. Don Edwards will introduce a bill clarifying copyright protection to semiconductor designs.

POSITION: SIA urges enactment of this legislation.

5. ELIMINATION OF SEMICONDUCTOR DUTIES

ISSUE: Tariffs on semiconductors constitute a barrier to trade and an additional cost which lessens U.S. competitiveness and diverts resources from R&D and capital investment.

STATUS: Authority is needed to reduce or eliminate U.S. semiconductor duties below present levels.

POSITION: SIA supports enactment of legislation to eliminate semiconductor duties as a means of encouraging other countries to take similar action.

6. ANTITRUST EXEMPTION FOR JOINT R&D

ISSUE: U.S. firms operate at a competitive disadvantage in relation to their foreign competitors because their joint R&D efforts through industry cooperative research organizations are deterred by U.S. antitrust laws.

STATUS: A number of legislative alternatives have been advanced to address this problem. Representative Edwards and Senators Glenn, Kennedy and Mathias favor one version. Senator Hart favors another.

POSITION: SIA would favor legislation to clarify U.S. antitrust laws with respect to joint R&D conducted through industry cooperative research organizations to strengthen the international competitiveness of U.S. firms.

SIA SEMICONDUCTOR INDUSTRY ASSOCIATION
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SIA POSITIONS ON LEGISLATIVE ISSUES 1983*

A. Trade Issues

1. LOCAL CONTENT LEGISLATION

ISSUE: Legislation was introduced in 1982 which would require most automobiles built in the U.S. to utilize predominantly U.S.-made parts and U.S. labor.

STATUS: This legislation will be introduced again in 1983 and strongly supported by the UAW.

POSITION: SIA opposes passage of local content legislation because risk of retaliation or emulation would endanger the high level of high technology exports.

2. FREEDOM OF INFORMATION FLOW

ISSUE: There have been efforts to increase government control over the technical information presented in journals, conferences and other forums to prevent its availability to potential foreign adversaries of the United States.

STATUS: There may be legislative or regulatory proposals to tighten controls on the dissemination of technical information.

POSITION: SIA believes that any such proposals deserve careful scrutiny for their potentially adverse effects on the free exchange of scientific and technical data.

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* The issues on which SIA will take a lead are identified separately. These are issues on which SIA will support the initiatives of others.

3. PERFORMANCE REQUIREMENTS

ISSUE:	Foreign governments impose trade-related performance requirements on foreign investors to achieve national policy objectives (local content rules, equity participation requirements, etc.).
STATUS:	The Administration is considering legislative proposals to increase its leverage in dealing with this problem.
POSITION:	SIA would support appropriate measures to enhance the President's ability to address this problem.

B. Tax Issues

1. DISC BENEFITS

ISSUE:	U.S. tax laws permit U.S. firms to defer a percentage of income from export sales (42%) from taxation ("DISC" provisions).
STATUS:	The administration is likely to propose legislation replacing DISC (Domestic International Sales Corporation) benefits in 1983 with a tax measure designed to provide comparable benefits to U.S. companies.
POSITION:	SIA supports continuation of the benefits provided by or a substitute for DISC which provides benefits substantially equivalent to the DISC as a means of stimulating U.S. exports.

2. INCREASE IN U.S. TAX BURDEN

ISSUE:	Due to the federal deficit, proposals are likely to be introduced in the 98th Congress which would increase taxes.
STATUS:	A variety of tax proposals are likely to be considered many of which could adversely impact the U.S. semiconductor industry.
POSITION:	If Congress deems it necessary to increase taxes, SIA will address these proposals on their merits. SIA would oppose any tax proposal which would disadvantage semiconductor firms in relation to companies in other industries.

3. UNIVERSITY EQUIPMENT DONATION INCENTIVES

ISSUE: High technology firms enjoy limited tax benefits from donation of inventoried equipment to universities.

STATUS: The American Electronics Association (AEA) will sponsor a bill which would expand the tax benefits accruing from equipment donation and extend the benefits to manufacturing and business equipment.

POSITION: SIA supports the AEA proposal.

4. REDUCTION OF LONG-TERM CAPITAL GAINS TAX

ISSUE: Reduction in the long-term capital gains tax would offer a greater incentive to equity investors.

STATUS: Proposals to reduce this tax could be introduced in 1983.

POSITION: SIA would support proposals to reduce the long-term capital gains tax.

5. DEPRECIATION SCHEDULES

ISSUE: New ACRS depreciation schedules adopted in 1981 inadvertently penalize firms with production equipment with a very short useful life.

STATUS: Little prospect of ACRS reform this year.

POSITION: SIA would support changes in the ACRS which would provide for expensing short-lived or obsolete equipment. SIA would oppose changes in ACRS which would further disadvantage semiconductor companies and supports extension and expansion of the R&D tax credit as a means of offsetting these disadvantages.

6. SECTION 861

ISSUE: At present IRS regulations are suspended which reduce the amount of foreign taxes which can be credited against a firm's tax liability by allocating R&D expenses to income earned abroad.

STATUS: This suspension will expire in 1983.

POSITION: SIA supports a reconsideration on a permanent basis of the IRS rules allocating R&D expenses to income earned abroad.

C. Technology Issues

1. INCREASED R&D SUPPORT

ISSUE: This year measures are likely to be proposed which emphasize incentives to R&D to increase the competitiveness of U.S. industries.

STATUS: It is not clear at present what form the proposed incentives will take.

POSITION: SIA would support consideration of such proposals on their merits but would oppose any proposals that would imply central government control or direction of commercial R&D efforts.

2. GOVERNMENT FUNDING FOR INDUSTRY COOPERATIVE RESEARCH

ISSUE: Proposals have been advanced to encourage government funding of industry cooperative research.

STATUS: SIA members have suggested this subject as an area of possible legislative action.

POSITION: SIA would support government funding of industry-led joint research programs such as the Semiconductor Research Cooperative provided that no conditions were attached to such funding.

D. Manpower issues

1. SCIENTIFIC/TECHNICAL EDUCATION INCENTIVES

ISSUE: Incentives are needed to increase the number of science and engineering graduates from U.S. institutions, and to improve the quality of education.

STATUS: The American Electronics Association (AEA) is developing a series of legislative initiatives in this area.

POSITION: SIA strongly urges support for legislative initiatives in this area as critical to the long term growth of the high technology industries.

2. SIMPSON/MAZZOLI

ISSUE: Legislation introduced (but not passed) in 1982 ("Simpson/Mazzoli Bill") potentially restricts the ability of foreign science and engineering graduates to work in the U.S. upon graduation.

STATUS: This legislation will be reintroduced this year.

POSITION: SIA opposes those portions of this bill which adversely affect the availability of engineers needed by U.S. industry. This could seriously impact our ability to grow in the U.S.

Chairman **Gibbons**. Thank you, sir. We will put all of your items in the record, because I notice you have here the SIA legislative priorities for 1983. I see that you are supporting the Danforth bill on high tech. Is that the same one we had in the House last year?

Mr. **Lidow**. Yes, it is.

Chairman **Gibbons**. I am going to have to go over your statement in greater detail. Mr. Jenkins?

Mr. **Jenkins**. No questions.

Chairman **Gibbons**. Mr. Frenzel?

Mr. **Frenzel**. I thank you for your expert testimony.

Chairman **Gibbons**. Mr. Schulze?

Mr. **Schulze**. No questions, Mr. Chairman.

Chairman **Gibbons**. Thank you. You have a very fine statement here and it is going to help us in understanding what we are seeing and working on.

Let me ask you, do you support the Stark legislation that he outlined here this morning, his first bill to reduce semiconductor tariffs to zero on a reciprocal basis?

Mr. **Lidow**. Yes, we do. We believe that it is a challenge to all the world economies that the U.S. semiconductor industry is willing to be a free trader. We are competitive, we do have the finest plants, we have the most efficient labor force and we are willing to challenge anybody on a fair turf.

Chairman **Gibbons**. Does the U.S. Semiconductor Association represent all the U.S. manufacturers of semiconductors?

Mr. **Lidow**. No, but we do represent a majority, quite a majority. I believe 80 percent of both captive and merchant producers.

Chairman **Gibbons**. Are there any big U.S. producers that are not members of your association?

Mr. **Lidow**. Texas Instruments is the largest.

Chairman **Gibbons**. Are they the only ones?

Mr. **Lidow**. I really cannot answer. There might be some captive producers that I would not know about that are not members that would also not be members.

Chairman **Gibbons**. Is Honeywell a member of your organization?

Mr. **Lidow**. I am not sure about that.

Chairman **Gibbons**. That is all the questions I have right now, thank you very much.

Mr. **Lidow**. Thank you.

Chairman **Gibbons**. Next we have a witness from the Electronics Industries Association of Japan, Mr. William Tanaka, who is their counsel. Mr. Tanaka, we welcome you. You may proceed as you wish.

STATEMENT OF H. WILLIAM TANAKA, COUNSEL, ON BEHALF OF THE ELECTRONIC INDUSTRIES ASSOCIATION OF JAPAN

Mr. **Tanaka**. Thank you, Mr. Chairman, members of the committee. My name is H. William Tanaka, of the law firm of Tanaka, Walders, & Ritger, and I am here on behalf of the Electronic Industries Association of Japan.

There are a number of questions which were raised by prior speakers to which I would like to respond.

First, with respect to the undervalued yen, I think that there are two sides to the coin. When you look at it from the Japanese side, the undervalued yen means, given the high import dependence of the Japanese economy for food and energy, that Japanese costs will be going up, and I suspect that these increased costs resulting from the depreciation of the yen will be reflected in higher prices on Japanese exports during perhaps the latter part of this year and the beginning of next year.

Obviously, the longer term contracts for the purchase of oil will have some moderating effect on the cost increases, but nevertheless, the fact that costs are rising as a result of the depreciation of the yen means higher aggregate cost of imports to the Japanese economy.

Certainly, as far as the yen is concerned, I agree with the chairman that the protectionism rising throughout the world is clearly having a depressing effect on the yen, so that those who call for restriction of imports from Japan are at the same time contributing to the psychology which results in the depression of the value of the yen in relation to the dollar.

Now, when you look at the depreciation of the yen and the appreciation of the dollar in relation to the yen and other currencies, this has another side also. The appreciation of the dollar means that an American based multinational corporation can, with the inflated dollar overseas, buy more land, more companies, or more materials at effectively a cheaper cost.

So, the currency changes do work both ways.

With your permission, I would like to proceed with my written statement, and read excerpts from it.

Chairman **Gibbons**. All right. We will place your entire statement in the record at the end of your testimony.

Mr. **Tanaka**. Thank you, Mr. Chairman.

A comforting belief widely held here is that high unemployment and chronic U.S. trade deficits with Japan result from unfair and inequitable Japanese business practices. More recently, emotionally charged criticism has targeted unfair structural characteristics of the Japanese economic order.

Such practices comprehend dumping, predatory pricing, subsidized exports, among others. Unfair structural characteristics comprehend unfair effects of cultural behavior and targeted industrial policy, including the closing off of market access and threatening the long-term viability of U.S. high-tech industries by distorting free market competition through aggressive exports by targeted industry products.

The instances where these unfair practices were found and remedial action taken and those pending are, of course, a matter of public record. However, what this perception ignores is the cost efficient and quality driven organizational dynamics of the Japanese industrial base. The notion that Japan achieved a trade surplus exceeding $70 billion, substantial profits, and rising levels of real income and living standards over more than 25 years by exploiting Japanese consumers in a high protected home market, while flooding world markets with high quality goods at below cost dumping propelled by large subsidies is, in my view, an exercise in self-deception of the most insidious sort.

As a premise for a national policy to revitalize the American industrial base and promote international competitiveness, it is not only risky, but dangerous. The fact is that frequently the petitioning industry, mesmerized by its own adversarial rhetoric, confuses successful implementation of prescribed legal remedies constraining imports with a complete solution to all of its ills.

I will give you the example of the auto voluntary export restraints. Now, what has been the dynamics of that voluntary export restraint? What it has done is to force Japanese auto companies to look for other high-tech areas, and as I am sure the committee members are familiar, companies like Nissan Motors are going heavily into aerospace activities. So, what the protectionist export restraints do is to push the Japanese economy increasingly toward high-tech industries.

This is precisely consistent with Japanese Government policies which encourage the underlying economic process, that is, the economic process which is technology driven, of disinvestment out of the low-growth, energy-intensive, labor-intensive, materials-intensive industries, sunset industries, and investment in the information-intensive and capital-intensive high technology industries.

Now, over the long term, what happens as a result of these voluntary restraints as far as the United States is concerned? Well, let us look at the textile industry, for example, where the first bilateral textile agreement was negotiated back in 1956, and this was transformed into a multilateral export restraint in 1962, and made into a multifiber export restraint in 1968.

The net effect of this has been to push the Japanese Government to shift the textile industry out of textiles and into leisure industries and other higher growth industries, while the protection afforded the domestic textile industry in a sense entrapped the workers, the management staff, and the capital resources in an industry which probably has a fairly low-growth, stable, but fairly low-growth future.

So, what we are doing, in effect, is to give protection to the low-growth, labor-intensive, low-technology industries, while the net impact of this restraint has been to push the Japanese into the higher-growth, the high-tech, the information-intensive industries, and in a sense today I think we are reaping in this country the results of protectionism that have been imposed on imports from Japan.

Having said this, I, however, do not suggest that appropriate laws to protect the domestic industry from unfairly traded imports and U.S. exports from unfair denial of market access are unnecessary. There is, of course, a demonstrated need for these laws to be in place.

Now, I would like to turn to some of the other, more general issues which have been raised by previous speakers with regard to bilateral trade.

The question of Japan's closed market, at least in my view, is that today this notion is more perceptional than real. Criticism regarding what is perceived to be unfair effects of Japanese behavioral and structural characteristics carries with it a very high emotional component, unlike American perceptions of unfairness in the conduct of Western industrialized countries.

This difference is in part a result of misperceptions born of lack of familiarity and understanding of Japan. Misinformation and misperceptions repeated often enough harden into facts. Then, what is the reality with respect to the claims of closed markets in Japan? Does in fact the bilateral trade imbalance support this conclusion?

The perception that Japan is one of the most difficult foreign markets to penetrate is probably accurate. The question is whether it has been unfairly made so. The McKinsey study concludes, and I quote, "It is hardly a closed or a controlled one." The study goes on to state:

> In fact, it is probably one of the most fiercely competitive economies in the world. The right to fail is an integral part of Japan's domestic scene. In fact, the number of bankruptcies of registered corporations in Japan in 1980 was about 14,000. This was 20 percent higher than those in the United States, although Japan's corporate population of 1.2 million companies is less than half that of America's.
>
> When you also consider the fact that the number of corporate dropouts in Japan grew at a rate of 6 percent, it is hardly surprising that the foreign affiliated companies find the going tough.

The rather startling fact is that U.S. business penetration of and presence in the Japanese marketplace is greater than is generally perceived, both in terms of the number of sectors penetrated and the depth of that penetration.

While U.S. imports as a share of Japan's total GNP was 1.9 percent, surprisingly, Japanese imports as a share of U.S. GNP was only 1.3 percent, or 32 percent less than U.S. export penetration of the Japanese market.

Now, when you put the import penetration in terms of a percentage of GNP, I think that this is the true measure, at least for merchandise trade, of the extent of penetration or the extent of accessibility of a market, and clearly, this suggests that the Japanese market is not a closed market in the sense that many of the previous speakers have alluded to this morning.

Moreover, in 1981, of the top 15 foreign profit makers earning a total of nearly $2 billion, 13 were U.S. investor-owned companies. Overall, the foreign affiliated companies in Japan performed better in terms of return on assets than did their Japanese counterparts.

The conclusion follows that prospective exporters and investors are being needlessly discouraged by uninformed assumptions about Japan's business prowess and market access problems.

More specifically, obstacles, both perceived and real, may be classified into three broad categories, regulatory, cultural differences, and internal company inhibitors. The McKinsey study indicates that although the Japanese market is a difficult and fiercely competitive one, it is less controlled than popularly believed, and in fact is no more closed or controlled from a legal standpoint than some Western markets.

For example, Japan restricts 27 product categories, only 5 of which are nonagricultural items. This compares favorably with the nonagricultural quantitative restrictions of France at 27, West Germany at 11, and the United States at 6.

In overall tariffs, Japan averaged around 3.2 percent, a little below most developed countries, including the Europeans and the United States.

With respect to NTB's, such as customs clearance procedures and standards, the Japanese Government is in the process of removing or reducing them, but at a pace which should desirably be accelerated to contain the frustration levels of trading partners within manageable limits.

The multilayered Japanese distribution system, variously characterized as a self-serving and highly effective NTB, under cover of an established business practice and tradition, is presently undergoing a major evolution. Increasingly, both Japanese and foreign companies are leapfrogging the layered distribution channels to reduce distribution costs.

Finally, most importantly, the McKinsey study concludes that the greatest hurdle U.S. firms face in Japan is the gap between headquarters' expectations and the marketplace realities. It concludes that the real and significant barriers in many cases have stemmed from a foreign corporation's failure or inability to recognize and accommodate the Japanese market's inordinate size, complexity, special needs, and conditions, traditional Japanese business customs, practices, and approaches to business relations.

Surveys conducted by this study indicate that local American managers regarded their headquarters' misperceptions as the single largest barrier to success. Since the rate of return on total assets and sales for American firms at home is twice that of Japanese companies at home, an American firm's financial criteria are often inappropriate for effective competition in Japan.

Turning to industrial targeting, industrial targeting as a component of industrial policy, particularly as it is practiced in Japan, is coming under increasing criticism. Some contend that industrial policies implemented by Japan inherently discriminate against imports and therefore must be fundamentally restructured.

Others are urging a dismantling of the system by which the Japanese Government is alleged to coordinate with and administratively guide private business sectors, especially clusters of companies grouped around banks and trading companies known as keiretsu.

Still others challenge the government initiated R&D consortiums with taxpayer funding of seed money as giving Japanese companies an unfair advantage over American companies who must pay for R&D funding out of their current earnings.

The fact is that the terms "industrial policy" and "industrial targeting" have become pejoratives, acquiring a conspiratorial gloss, and the use of these terms tends to obfuscate rather than clarify their substance.

A bit of history may be helpful in clearing away some of the obfuscating gloss which these terms have acquired. The notion of targeted funding of designated industries regarded as important to national economic growth has its beginnings in the "keisha seisan hoshiki," which translates into the awkward appelation, "priority targeted production system."

Developed by an informal advisory group in 1946, approved by occupation authorities and adopted by both the Japanese Government and the Supreme Commander for the Allied Powers, the unwieldy term, "priority targeted production system," was then described by one of the advisory groups who developed the idea somewhat as follows, and I will not read the quotation.

Priority targeted production system is a system wherein industries needed for the rapid recovery of the war-torn economy are designated as important, first of all, and then, within the designated industries, priority in terms of funding is assigned.

In the initial stages of this industrial targeting measure, coal and steel were selected as the two most important targeted industries or priority designated industries, because coal would provide source material for fertilizer which was needed to start up agriculture, steel was needed to provide equipment, and mining and transportation equipment for the coal.

So, one can say that the present-day industrial targeting practice has a long history which goes back at least to 1946, during the occupation, when the Supreme Commander of the Allied Powers, in response to a change in directive from Washington ordering quick recovery of the economy, was looking for both macroeconomic policies and microeconomic implementation to speed the economic recovery of Japan. It was during that period when Japan was suffering constraints of materials, energy, and food shortages that this idea of industrial targeting was born.

When one looks at the history of the evolution of industrial targeting practice, there does not seem to be anything insidious or conspiratorial about it. As a matter of fact, it would appear, at least in my judgment, to be a very practical response to a situation where an economy is prostrate and where food, shelter, and clothing were not available, and the industrial base was pretty well devastated by the saturation bombing.

Under those circumstances, this policy seems most appropriate and effectively designed to make the best possible use of people resources and of the other resources that were available.

Second, while I am discussing the occupation period, I might note that this committee has expressed, in connection with testimony given by earlier witnesses, an interest in NTT procurement policy. I would like to tell you an interesting story about how NTT procurement policy evolved.

This also goes back to the occupation. As a matter of fact, I have here a xeroxed copy of a recommendation from General Headquarters, Supreme Commander of the Allied Powers, dated May 12, 1951, and addressed to the Japanese Telecommunications Ministry. A copy is supplied for the record entitled, "Summary of Suggestions and Recommendations's Made to MOTC by Tel and Tel Division, May 12, 1951" from General Headquarters, SCAP

Essentially, the substance of this recommendation was that the procurement practice of NTT, which had been purchasing its equipment in the open market—for example, certain components—from seven or eight manufacturers, was found to be very cost ineffective and not conducive to promoting the reliability of the telecommunications system upon which the occupation forces relied.

So, what had happened was that SCAP's Economic and Scientific Section had called over engineers from AT&T and Western Electric to look at the procurement policies of NTT to see how its procurement policy might be improved so as to establish better quality control over the components which went into the system, and thereby improve the overall efficiency and reliability of the telecommunications system in Japan.

The results of the survey were put into this recommendation, which went to the Telecommunications Ministry, and the nub of the recommendation was that, No. 1, a designated supplier system should be established, and each of these designated suppliers should specialize in the manufacture and designing of certain components which went into the telecommunications system.

This would, according to the recommendation, enable NTT to maximize cost efficiencies gained through scale and learning economies. That is, to achieve these economies by concentrating production of a component in one company instead of seven or eight.

Second, a designated supplier system would enable NTT's engineers to coordinate more effectively the designing and production process of the components which went into the system.

As a result of this recommendation, which in effect was an order to the Japanese Government, the Japanese ministry took action to implement it, with the result that after the designated supplier system came into use, no outside telecommunications equipment supplier could bid on any NTT procurement program.

Thus, even Japanese companies, for example, Matsushita, which has a very good communication equipment manufacturing capability, could not bid on NTT equipment.

So, the NTT procurement policy historically was not designed to keep foreigners out of the market, but rather in its genesis was a procurement system designed to improve the reliability and quality of the national telecommunications system in Japan which the occupation forces relied upon.

Therefore, until 2 years ago, NTT had continued to implement what they had learned from AT&T engineers back in 1951.

I would like to continue with the industrial targeting practices. During the 1950's and 1960's Japan's national policy emphasis shifted from economic recovery to economic growth. The fact that this new national policy gained broad popular support is probably the key to the stunning economic growth that Japan achieved during these years in increasing productivity, upgrading product quality and developing international cost competitiveness over a broad range of products, including steel, shipbuilding, and consumer products.

The dynamics of the economic process in Japan suggest that increased western protectionism against burgeoning Japanese exports, starting with the cotton textile products, has effectively served to assist the Japanese Government in accelerating disinvestment out of materials, energy and labor-intensive low-growth, mature technology industries, and shifting investment into nonpolluting technology and capital intensive high-growth industries.

Conversely, protectionism in the United States, beginning with the bilateral cotton textile agreement which I alluded to earlier, has resulted in delaying and causing stickiness in the process of disinvestment out of the low-growth, labor-intensive, low-technology industries such as textiles, steel, et cetera.

In a sense, industrial policy as implemented in Japan is nothing more or less than a coordinated and mutually reinforcing effort which nudges and guides the underlying technology-driven economic process of disinvestment out of sunset industries and investment in the sunrise industries. The economist Schumpeter has described this weeding out of sunset industries and emergence of sunrise industries as a continuing process of creative destruction.

Now I would like to turn to the semiconductor issue. In discussing the effects of Government involvement in the promotion of the Japanese semiconductor industry, one must not lose sight of the major role that the U.S. Government procurement and R&D funding has had in the development of the U.S. semiconductor industry, as well as computer and telecommunications industries. During the 18-year period 1952 through and including 1969, U.S. Government-funded procurement and R&D services sales by the U.S. electronic industry increased from $3.1 billion in 1952 to $12.3 billion in 1969, an almost fourfold increase. This amounted to about $120 billion in the aggregate.

More importantly, during this 18-year period, U.S. Government-funded procurement and R&D services consistently exceeded 50 percent of the total product output of the entire U.S. electronic industries.

The Defense Department played a major role in the development of integrated circuits, particularly in funding R&D directed toward developing production technologies for electronic miniaturization and increased reliability. In 1958 DOD provided as much as 23 percent of R&D funds to the semiconductor industry, not including the DOD independent research and development reimbursement to the industry.

Following the development of the integrated circuit at Texas Instruments in 1958, the Air Force awarded two contracts in 1959 and 1960 to Texas Instruments totaling $3.2 million for their development, including development of production processes. The DOD R&D support of integrated circuits continued in the range of $4 to $6 million in the period 1960 to 1964.

With respect to computers, U.S. Government security agencies have played a major role in their development. The National Security Agency played a key role in the development of the modern computer. Research funds provided by the Agency to such companies and institutions as RCA, the International Business Machines Corp. and MIT hastened the start of the computer age.

What I am suggesting here is that, while these industries constituting a part of the military-industrial complex have been aided and assisted by Government-funded R&D, by Government-funded procurement, through which it has realized scale economies and learning economies, the net effect of this policy is no different in terms of hastening the creation and growth of these industries from industrial policy as it is practiced in Japan.

The unfortunate part of the adversarial mind is that it tends to view solely in a bipolar context the effects of Japan's targeted practice in relation to its impact on the United States industry. However, if we look to the north, to Canada, we find that the Canadian Government is nationalizing sector after sector, starting with the high-tech industries.

Let us look at Europe. France has nationalized sector after sector, starting with the telecommunications industry, the semiconductor industry, and every high-technology industry, so that in effect the high tech-industry in France is in bed with the French taxpayers and the French Government.

One often hears that American entrepreneurs cannot compete with the Japanese because they are fighting Japan, Inc. Well, a political phenomenon much worse than industrial policy is taking place in Europe, particularly in France and the United Kingdom. For example, the major semiconductor manufacturer Inmos is entirely owned by the British Government and it has a production facility someplace in Colorado Springs, Colo.

But this is what is going on throughout the world. Now, if industrial targeting instituted by Japan is culpable, then what would be your opinion regarding the galloping state enterprise capitalism that is spreading in Canada and the United Kingdom and in Italy and France, and increased subsidies in West Germany?

So we must look at the totality of the world instead of in bipolar segments, in order to get a better grasp of what is going on in the world with respect to Government-industry relations. I think that the ultimate result of all of this Government-industry involvement with each other will be that the United States will also move in the same direction, and that ultimately there will be some convergence in national objectives and practices between the major industrial powers.

I think that the real glue and cement that will make this converging of national objectives and practices work is the increasing interties between semiconductor manufacturers in the United States, semiconductor manufacturers in Europe, and semiconductor manufacturers in Japan, through joint ventures, cross-license agreements, et cetera, so that each industry can build upon the technological development of the other partner, so that all of the industries will ultimately gain in terms of expanding the size of the pie, instead of slicing the shrinking pie in beggar they neighbor fashion.

Thank you, Mr. Chairman, for your patience.

[The prepared statement and additional material follow:]

STATEMENT OF H. WILLIAM TANAKA, ON BEHALF OF THE ELECTRONIC INDUSTRIES ASSOCIATION OF JAPAN

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you to present testimony on behalf of the Electronic Industries Association of Japan.

The Problem

A comforting belief widely held here is that high unemployment and chronic U.S. trade deficits with Japan result from unfair and inequitable Japanese business practices. More recently, emotionally-charged criticism has targeted unfair structural characteristics of the Japanese economic order. Such practices comprehend dumping, predatory pricing, subsidized exports, among others. Unfair structural characteristics comprehend "unfair effects" of cultural behavior and targeted industrial policy including the closing off of market access and threatening the long term viability of U.S. high-tech industries by distorting free market competition through aggressive exports by targeted industry products. The instances where these unfair practices were found and remedial action taken, and those pending, are a matter of public record.

This document has been filed by H. William Tanaka with the Departme
of Justice Under Provisions of 22 U.S.C. 611, et seq., as an ag
the Electronic Industries Association of Japan. Copies of his registra
statement are available for public inspection in Department of Justi
files. Registration does not indicate approval of the contents of [illegible]
release by the [illegible]

However, what this perception ignores is the cost-efficient and quality-driven organizational dynamics of the Japanese industrial base. The notion that Japan achieved a trade surplus exceeding $70 billion, substantial profits, and steadily rising levels of real income and living standards over more than 25 years by exploiting Japanese consumers in a highly protected home market, while flooding world markets with quality goods at below-cost dumping propelled by large subsidies, is, in my view, an exercise in self deception of the most insidious sort.

As a premise for a national policy to revitalize the American industrial base and promote international competitiveness, it is not only risky but dangerous. The fact is that, frequently, the petitioning industry, mesmerized by its own adversarial rhetoric, confuses successful implementation of prescribed legal remedies constraining imports with a complete solution to all of its ills.

Having said this, I, however, do not suggest that appropriate laws to protect the domestic industry from fair and unfair traded imports, and U.S. exports from unfair denial of market access, are unnecessary. There is, of course, a demonstrated need for these laws to be in place. Now I turn to some of the issues raised in U.S.-Japan trade.

"Japan's Closed Home Market", More Perception Than Reality

Criticism regarding what is perceived to be unfair effects of Japanese behavioral and structural characteristics carries with it a very high emotional component unlike American perceptions of unfairness in the conduct of Western industrialized countries. This difference is, in part, a result of misperceptions borne of lack of familiarity and understanding of Japan. Misinformation and misperceptions, repeated often enough, harden into "facts". Then, what is the reality with respect to claims of closed Japanese markets? Does, in fact, the bilateral trade imbalance support this conclusion?

The perception that Japan is one of the most difficult foreign markets to penetrate is probably accurate. The question is whether is has been "unfairly" made so. The McKinsey study concludes, "it is hardly a closed or controlled one."[1] The study goes on to state:

> In fact, it is probably one of the most fiercely competitive economies in the world. The right to fail is an integral part of Japan's domestic scene. In fact, the number of bankruptcies of registered corporations in Japan in 1980 was about 14,000. This was 20 percent higher than those in the United States, although Japan's corporate population of 1.2 million is less than half (40 percent) that of America's. When you also consider the fact that the number of corporate dropouts in Japan grew at a rate of 6 percent (which was 4 and one-half times greater than the rate in the United States), it is hardly surprising that FACs [foreign affiliated company] find the going tough.

The rather startling fact is that "U.S. business penetration of and presence in the Japanese marketplace is greater than is generally perceived, both in terms of the number of sectors penetrated and depth of penetration."[2] A simple means to demonstrate this would be to calculate the relative export penetration of each country's market. While U.S. imports as a share of Japan's total GNP was 1.9 percent, surprisingly Japanese imports as a share of U.S. GNP was only 1.3 percent, or 32 percent less than U.S. export penetration of the Japanese market.[3] Moreover, in 1981, of the top 15 foreign profit-makers earning a total of nearly $2 billion, 13 were U.S. investor-owned companies. Overall, the foreign affiliated companies (FACs) in Japan performed better in terms of return on assets than did their Japanese counterparts.

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[1] McKinsey & Company, Inc., "Japan: Obstacles and Opportunities", November 30, 1982.

The conclusion follows that prospective exporters and investors are being needlessly discouraged by uninformed assumptions about Japan's business prowess and market access problems.

More specifically, obstacles, both perceived and real, may be classified into three broad categories: regulatory, cultural differences, and internal company inhibitors.

The McKinsey study indicates that although the Japanese market is a difficult and a fiercely competitive one, it is "less controlled than popularly believed and, in fact, is no more closed or controlled from a legal standpoint than some Western markets." For example, Japan restricts 27 product categories, only five of which are non-agricultural items. This compares

[2] Ibid

[3] Ibid.

favorably with the non-agricultural quantitative restrictions of France at 27, West Germany at 11, and the U.S. at 6. In overall tariffs, Japan averaged around 3.2 percent -- a little below most developed countries including the Europeans and the United States.

With respect to NTB's such as customs clearance, testing procedures and standards, the Japanese government is in the process of removing or reducing them, but at a pace which desirably should be accelerated to contain the frustration levels of trading partners within manageable limits.

The multi-layered Japanese distribution system, variously characterized as a self-serving and highly effective NTB under cover of an established business practice and tradition, is presently "undergoing a major evolution." Increasingly, both Japanese and foreign companies are leapfrogging the layered distribution channels to reduce distribution costs.

Finally, most importantly, the McKinsey study concludes that "the greatest hurdles U.S. firms face in Japan are the gap between headquarters' expectations and the marketplace realities." It concludes that real and significant barriers in many cases have stemmed from a foreign corporation's failure or inability to recognize and accommodate:

> (1) "The Japanese market's inordinate size, complexity, special needs, and conditions"
>
> (2) "Traditional Japanese business customs, practices and approaches to business relations."

Surveys conducted by the study indicated that local American managers regarded their headquarters' misperceptions as the single largest barrier to success. Since the rate of return on total assets and sales for American firms at home is twice that of Japanese companies at home, an American firm's financial criteria are often inappropriate for effective competition in Japan.

Industrial Targeting

Industrial targeting as a component of industrial policy, particularly as it is practiced in Japan, is coming under increasing criticism. Some contend that industrial policies implemented by Japan inherently discriminate against imports, and therefore must be "fundamentally restructured". Others are urging for a dismantling of the system by which the Japanese government is alleged to coordinate with and administratively guide private business sectors, especially clusters of companies grouped around banks and trading companies known as "keiretsu". Still others challenge the government-initiated R&D consortiums with taxpayer funding of seed money as giving the Japanese companies an unfair advantage over American firms who must pay for R&D funding out of their current earnings.

The fact is that the terms "industrial policy" and "industrial targeting" have become perjoratives acquiring a conspiratorial gloss and the use of these terms tends to obfuscate rather than clarify their substance. A bit of history may be helpful in clearing away some of the obfuscating gloss which these terms have acquired.

The notion of targeted funding of designated industries regarded as important to national economic growth has its beginnings in the keisha seisan hoshiki, (priority targeted production system), developed by an informal advisory group and adopted by both the Japanese government and the Supreme Commander for the Allied Powers (SCAP) in 1948. The unwieldy term, priority targeted production system, was described by one of the advisory groups who developed the idea as follows:

> Our idea is to concentrate our efforts on increasing the production of coal, which is one of the most important basic materials, and which is present in Japan. We insist that all economic policies should be geared to this purpose. This has the highest priority among policies. This high priority may not be long assigned to this particular policy, and possibly it will not be necessary for a long period. However, when we cannot expect an all around increase in production because of numerous constraints and difficulties, there is no alternative but to concentrate on a few basic commodities and through the increased production of these items, we may create the possibility of gradual recovery of over-all production activities.[4]

At that time, the first phase of the Occupation, namely the demilitarization of Japan and implementation of policies to democratize its social and economic structure such as land reform, promotion of labor union activities, and the dissolution of the zaibatsu holding companies, was implemented. At the same time, with the complete destruction of the industrial base, both industrial and agricultural production were at a virtual standstill. It was this standstill in industrial and agricultural activities, and the consequent rampant inflation and serious food shortage, that shaped the thinking of the advisory group, who concluded that direct economic controls, including allocation of scarce materials and capital funds, rationing of food and other necessities, and price controls, were imperative. The first of these industries targeted for special materials and funding priorities was coal mining and steel, and SCAP approval of importation of heavy oils was requested to increase steel production so that mining and hauling equipment could be made available to reopen and step up coal mine production.

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[4] Arisawa, Professor Hiromi, "Measures to Prevent Economic Collapse", Hyoron, January 1947.

The priority targeted production program, assigning top priority to coal production, resulted in output exceeding by 3 million tons the then virtually impossible target of 27 million tons. Increased coal supplies, in turn, accelerated the recovery in basic goods production including fertilizers and cement, and helped in rehabilitating the railway system. Thus, industrial targeting as a technique designed to promote economic recovery and subsequent growth had its genesis in the priority targeted production system developed during the Occupation in circumstances of severe materials, energy and food constraints, and rampant price inflation.

There is nothing in its history which could be considered conspiratorial or sinister. It was simply a very practial response to an overwhelming need for cost-efficient management of resources to speed economic recovery. By 1947, the objective of the Occupation was already shifting sharply from a demilitarization and democratization objective to hastening economic recovery because of the onset of the Cold War and the change in U.S. military and foreign policy objectives in East Asia, vis-a-vis the Soviet Union.

During the 1950s and 60s, Japan's national policy emphasis shifted from economic recovery to economic growth. The fact that this new national policy gained broad popular support is probably the key to the stunning economic growth that Japan achieved during these years in increasing productivity, upgrading product quality, and developing international cost competitiveness over a broad range of products including steel, shipbuilding, and consumer products.

The dynamics of the economic process in Japan suggests that increased Western protectionism against burgeoning Japanese exports, starting with the cotton textile products, has effectively served to assist the Japanese government in accelerating disinvestment out of materials, energy and labor intensive, low growth, mature technology industries and shifting investment into non-polluting, technology and capital intensive high growth industries. Conversely, protectionism in the United States, beginning with the bilateral cotton textile agreement in 1956, the multilateral textile export restraints agreements in 1962, and the multifiber textile export restraints in 1968, has served to retard the technology-driven economic process of resource disinvestment out of the mature technology textile industry. In the context of this constant process of technology-driven economic shifts in resource commitments, one unfortunate result of protection is the entrapment of workers, managerial staff, and capital in an industry facing substantial shrinkage as America's level of interdependence grows. The same thing did happen in the vacuum tube radio industry, tube and hybrid type audio and television industries, as well as companies in the steel industry, which had been using the open hearth process long after more cost efficient steel making technology became available.

In a sense, industrial policy as implemented in Japan is nothing more or less than a coordinated and mutually reinforcing effort, which nudges and guides the underlying technology-driven economic process of disinvestment out of sunset industries and investment in the sunrise industries. The economist Schumpeter has described this weeding out of sunset industries and emergence of sunrise industries as a continuing process of creative destruction.

In any event, the recent spate of protectionism throughout the world constraining Japan will, in my view, stimulate Japanese business toward achieving greater cost efficiencies and generating more new products through increased basic and developmental R&D effort.

As for the United States and other industrialized economies, whether or not these economies will benefit from a temporary constraint on imports, whether in the sunset or sunrise products, will depend in part upon the collective responses of their business communities. If the respite gained is not used in achieving cost efficiencies, upgrading quality, and promoting longer term R&D, the results could be a further diminution of competitiveness when restraints are removed.

The Semiconductor Issue

In discussing the effects of government involvement in the promotion of the Japanese semiconductor industry, one must not lose sight of the major role that the U.S. government procurement and R&D funding has had in the development of U.S. semiconductor, computer and telecommunications industries. During the 18 year period, 1952 through and including 1969, U.S. government-funded procurement and R&D services sales by the U.S. electronic industries increased from $3.1 billion to $12.3 billion in 1969, an almost fourfold increase. More importantly, during this 18 year period, U.S. government funded procurement and R&D services consistently exceeded 50 percent of the total sales by the U.S. electronic industries.[5]

The Defense Department played a major role in the development of integrated circuits, particularly in funding R&D directed toward developing production technologies for electronic miniaturization and increasing reliability. In 1958, DOD provided as much as 23 percent of the R&D funds to the semiconductor industry, not including the DOD independent research and development reimbursement to the industry.[6]

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[5] Electronic Industries Association, "Electronic Market Data Book", 1971, page 2.

[6] Institute for Defense Analyses, "The Role of the Department of Defense in the Development of Integrated Circuits", May 1977,

Following the development of the integrated circuit at Texas Instruments in 1958, the Air Force awarded two contracts in 1959 and 1960 to Texas Instruments totalling $3.2 million for their development, including development of production processes. The DOD R&D support of integrated circuits continued in the range of $4-6 million in the period 1960 to 1964.[7]

With respect to computers, U.S. government security agencies have played a major role in their development. The National Security Agency "played a key role in the development of the modern computer."[8] Research funds provided by the Agency "to such companies and institutions as the Radio Corporation of America, the International Business Machines Corporation, and the Massachusetts Institute of Technology 'hastened the start of the computer age'".[9]

In addition to defense and security related industries, historically the U.S. agricultural industry has been given national priority in education and training, research and development, outright subsidies and protection from import competition. As a result, in part, from this sustained government targeting effort, the United States has developed the most competitive agricultural industry in the world. If any culpability attaches to any "effects" manifested overseas resulting from this industrial targeting, the United States is no more nor no less culpable than any other government which engages

[7] Ibid, p. S-1.
[8] The New York Times, February 1, 1979.
[9] Ibid.

in similar targeting conduct, but with substantially poorer results, including Japan and the European countries.

Accordingly, if implementing what is perceived to be a highly successful industrial targeting is culpable, culpability should not be a function of the level of perceived success achieved. John Zysman, a professor at Berkeley's Institute of International Studies, said:

> The problem with going after industrial policy is that it amounts to declaring Japan illegal. You can't just do that.

Professor Chalmers Johnson, who published a book on MITI and industrial policy, has said in this regard:

> Any government that cannot define its role in the economy is in trouble. Japan has found a workable way to do that and the U.S. has not.

Let us look at the specifics regarding government funding of IC-related research and development. A study by the U.S. Commerce Department entitled, "A Report on U.S. Semiconductor Industry", September 1979, states:

> In 1978, the Semiconductor Industry Association estimated that U.S. government and private industry spent $2,415,000,000 on semiconductor research and development during 1958-1976, of which $1,315,000,000 was spent from 1970-1976. The U.S. government share of the $2,415,000,000 was $702,000,000....

Total U.S. government funding in IC-related research and development consisting of non-very high speed integrated circuits (VHSIC) and VHSIC for the fiscal years 1978 through 1982 amounted to $278,819,000.[10] However, the U.S. and Japan are not the only governments funding large scale integration projects. All major industrialized countries including France, UK, West Germany, Japan, and the United States, conduct such programs. (See Table 1). A comparison of R&D expenditures as a percent of GNP indicates that West Germany topped the four major countries with 2.34 percent of its GNP (1978), followed by 2.18 percent for the U.S. (1979), Japan with 1.83 percent (1979), and France with 1.76 percent (1979). (See Table 2).

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[10] National Research Council, "An Assessment of the Impact of the Department of Defense Very-High Speed Integrated Circuit Program", 1982, page 21.

The SIA claims that the Japanese government is granting substantial subsidies to its semiconductor industry. While it is indeed true that the Development Bank of Japan is financing a part of the capital requirements of the semiconductor industry, total loans to this industry amount to a figure less than 1 percent of such loans (See Table 3). Moreover, total Development Bank loans to the semiconductor industry are estimated at a few percent of the total industry investment. The interest cost savings for such loans are in the range of 1 percent per annum.

Regarding beneficial tax treatment, under U.S. tax laws, the depreciable life of production equipment for semiconductors is 5 years, but under Japanese tax laws, the 5 year depreciable life of production equipment is specifically limited to such equipment for the manufacture of integrated circuits. For other semiconductor devices, the depreciable life is 7 years.

64K RAM Issue

Regarding the allegations that the Japan is taking over the U.S. RAM market, what is clear is that U.S. RAM manufacturers were not ready to supply the 64K RAMs to American systems manufacturers when the market began emerging toward the end of 1981. With the exception of one or two U.S. RAM manufacturers, most were still in the process of debugging their sample runs, and others were encountering quality problems in their commercial runs. The plain fact is that when IBM, Hewlett-Packard and other systems manufacturers asked for 64K RAMs, some of the U.S. manufacturers responded with offers to sell the rapidly fading 16K RAMs. Confronted with this situation, U.S. systems manufacturers turned to imported 64K RAMs in order to maintain technological leadership in the finished product.

This situation repeats the shortage of 16K RAMs which occurred in 1978 and 1979. During that period, systems manufacturers such as NCR and others complained that the shortage of 16K RAMs depressed their profits and sales of systems products. Meanwhile, domestic producers of the 16K RAMs sharply increased their orders for these units from their Japanese competitors in order to satisfy the requirements of their systems customers. As a result, U.S. manufacturers of semiconductors accounted for the greatest share of increase in imports of 16K RAMs from Japan in 1979. A bad management decision in the 1975-76 period not to invest in production facilities for the manufacture of these units was responsible for the shortage.

Thus the shortage in 64K RAMs, which developed in 1982, likewise resulted from the failure of American management to invest in technology for the manufacture of 64K RAMs during the 1978-79 period. Unless the U.S. producers have made timely investments with respect to the 256K RAM production, a similar pattern could emerge again.

Earlier, one of the major reasons advanced by SIA members for the 16K RAMs shortage situation encountered in 1979 was the claim that they were unable to generate the capital necessary to make the required investments. What has happened since then indicates that the capital shortage problem has largely been alleviated. Mostek was acquired by United Technologies, a diversified manufacturer. Intersil was acquired by General Electric, Fairchild was acquired by Schlumberger, a French manufacturer, Intel established a vertical linkage with a major user of its product, IBM, when IBM purchased Intel's shares at a price in excess of $200 million.

This restructuring trend toward vertical integration of the major merchant manufacturers now provides ample opportunities to these captive producers for obtaining required longer-term funding for capital investments and research and development, as well as the important benefit of a captive market. This vertical restructuring of the industry opened additional integrated access to capital and markets in a manner comparable to the Japanese producers.

The major Japanese semiconductor manufacturers are integrated producers, who became semiconductor producers by backward vertical integration. There are no major non-integrated merchant producers of semiconductors in Japan. This structure of the Japanese industry does make it more difficult for foreign merchant producers to sell, the reason being that foreign producers are selling to their Japanese competitors. Being manufacturers themselves, Japanese purchasers tend to be much more selective with respect to quality, service capability, and whether or not the product is state-of-the-art.

Bilateral Trade in Semiconductors

In connection with an examination of bilateral trends in semiconductor trade, it is of interest to note that at least 11 American semiconductor manufacturers have established sales or manufacturing operations or both in Japan. American manufacturers manufacturing locally include Texas Instruments, Motorola, Analog Devices, and Fairchild, which has announced plans to build a plant in Japan. Intel has established a research and designing center in Japan and is believed to be contemplating establishment of a plant. These trends suggest that the plants established in Japan by American firms will be supplying both local requirements as well as a part of the requirements for the U.S. market. If so, this signifies increases in imports of ICs from Japan accounted for by U.S. investor owned facilities.

Is the $18 Billion Bilateral Trade Deficit a Meaningful Yardstick?

Bilateral trade statistics by themselves are not a very meaningful measure of the relative closedness of the Japanese market nor of the competitiveness of U.S. business. Bilateral trade balance reflects export sales of merchandise only, and does not include services and profits generated through the distribution process of a third country. For example, American operations in Japan generated more than $20 billion, as compared with Japanese operations in the United States, which generated only $5 billion in 1980. Moreover, bilateral trade figures for tangible product do not include billions of litres of crude oil and basic petroleum products that are exported to Japan from third countries by U.S. firms. In 1980, U.S. firms shipped $21 billion in crude oil to Japan, but the associated profits are not reflected in U.S.-Japan bilateral merchandise trade figures.

Specifically with respect to U.S. exports of ICs, based on 1981 U.S. Commerce Department data, Japan was the second largest market for U.S. IC exports following West Germany, with the former accounting for 15.5 percent and latter 17.6 percent. A breakout by IC category shows that Japan is the number one purchaser of U.S. linear ICs accounting for 17.9 percent, with West Germany being second, accounting for 15.4 percent of total linear IC exports. In bipolar digital ICs, West Germany was first with 19.3 percent, and Japan second, also with 19.3 percent. With respect to MOS logic, Japan was first with 18.9 percent, and West Germany second with 13.3 percent. With respect to MOS memory, West Germany was first with 17.7 percent, France second with 15.3 percent, and Japan third with 13.4 percent. In MOS RAM 9K and greater, France was first with 52 percent, West

Germany second with 12.9 percent, and Japan sixth with 3.7 percent. In the "others" category, West Germany was first with 21.9 percent, Taiwan second with 15.1 percent, and Japan third with 10.4 percent.

These figures showing high or leading shares of purchases of U.S. ICs by Japan suggest that the Japanese market for U.S. ICs may not be as closed as frequently alleged.

In terms of the bilateral trade balance in ICs, according to Ministry of Finance figures, the favorable U.S. trade balance of 25.3 percent in 1977 increased to 32.3 percent in 1979, but dropped sharply to a negative balance of -2.8 percent in 1980, a virtual equilibrium in 1981 of -0.7 percent, and a further drop to -9 percent in 1982. The drop in IC trade balance to a minus factor in 1980 reflects, in part, U.S. capacity shortage in 16K RAMs resulting from capacity underinvestment in 1975 and 1976. While 1981 IC trade flows were in relative balance, U.S. IC trade deficit increased in 1982, in part, because capacity and production shortages of the 64K RAMs resulted in increased imports from Japan. In addition, some U.S. manufacturers of the 64K RAMs ran into production difficulties and quality problems, which further delayed the onset of full domestic production.

Conclusion

The rapid shifts in semiconductor production and sales epitomize the technology-driven process of "creative destruction". American systems manufacturers upgraded their requirements from the 16K RAMs to the 64K RAMs as soon as quality reliable 64K RAMs became available in commercial quantities. This is technological predation operating in the marketplace in its most brutal form. Yet, in a technology-driven society, one must face the fact that the only constant is the constancy of change. Competitive survival means continuing adjustments to the accelerating tempo of innovation. Since technology does not yield to governmental constraint, a resourceful businessman has no choice but to ride the crest of innovation where the risks are high but rewards greater.

Thank you.

TABLE 1

LSI PROJECTS OF MAJOR COUNTRIES

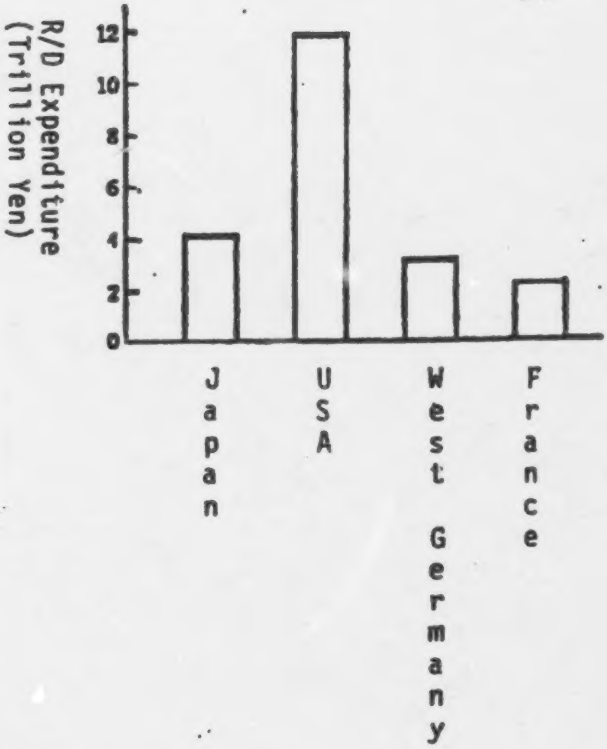
	FRANCE	U.K.	WEST GERMANY	JAPAN	U.S.A.
YEAR	1978 - 1982	1978 - 1982	1979 - 1981 (Undecided)	1976 - 1979	1979 - 1986
GOVERNMENT FUNDS	600 million franc (25 billion yen) Computer project total-2.5 billion franc (104 billion yen)	140 million dollars (28 billion yen) All LSI project total 400 million pounds (156 billion yen)	100 million dollars (Undecided) (20 billion yen)	150 million dollars (30 billion yen)	313 million dollars (62 billion yen)
PROJECTS	Computer projects . Development of computer industry . VLSI projects featuring Thompson-CSF group-200 million franc (8,320 million yen) Develop 2 μm lithography by 1981 Develop 1 μm lithography by 1983 . Expansion of communication network . Promotion of computer education at schools . Establishment of Information Ministry	. Publicity of LSI to the nation . Education of engineers and workers . Financial assistance to the industry . Investment of 50 million pounds(19.5 bil. yen) to Inmos. Massproduction of 64K RAM by 1980 . Publicity of LSI used products	. R/D by the government agencies, Siemens, Valvo, AEG, etc. . The government agency to develop the basic researches. Electron Beam equipment . Siemens to build a pilot line for 2 μm VLSI . Valvo to build clean room	. VLSI Technology Research Association conducted VLSI R/D at 1 cooperative laboratory and two group laboratories . Establish basic technology for manufacturing the VLSI to be used for the next generation electronic computers.. . R/D in the area of: (1) Microfabrication technology (2) Crystal technology (3) Design technology (4) Process technology (5) Test and evaluation technology (6) Device technology	. Phase 0 Concept definition and detailed plans . Phase I System brassboard development/pilot production of 1/4 μm chips/ sub-μm technology development . Phase II System demos using developed brassboard/ sub-μm chip pilot production . Phase III R/D anticipated and defined problem areas-innovation

Source: Ministry of International Trade & Industry, Japan --- France, U.K., West Germany, Japan

Semiconductor Research Cooperative --- U.S.A.

TABLE 2

INTERNATIONAL COMPARISON OF R/D EXPENDITURE



R/D Expenditure as percent of GNP (%)	1.83 (1979)	2.18 (1979)	2.34 (1978)	1.76 (1979)
Total R/D Expenditure (Trillion Yen)	4.08	11.9	3.19	2.24

Source: Science and Technology Agency of Japan

TABLE 3

JAPAN DEVELOPMENT BANK: NEW LOANS BY INDUSTRY

(IN BILLIONS OF YEN)

	FY 1980	Cumulative FY 1976-80	Cumulative Distribution
Non-manufacturing			
Agriculture and fisheries	¥4.0	¥19.3	0.44%
Mining	9.8	31.6	0.73
Construction	2.6	20.7	0.48
Wholesale and retail trade	9.9	84.6	1.95
Real estate	30.7	287.5	6.62
Transport and communication	216.8	803.3	18.51
Electricity, gas, thermal supplies and water supplies	419.7	1,511.9	34.83
Services and other non-manufacturing	72.9	364.0	8.39
Sub-total	766.4	3,122.9	71.95
Manufacturing			
Foodstuffs and beverages	6.9	58.0	1.34
Textile products	7.8	39.3	0.91
Pulp, paper and related products	7.5	47.7	1.10
Chemical products	29.0	217.1	5.00
Petroleum refining	47.0	220.6	5.08
Ceramic, stone, clay, glass and related products	29.8	87.3	2.01
Iron and steel	33.7	258.0	5.94
Non-ferrous metals	10.4	61.0	1.40
Fabricated metal products	6.7	26.3	0.61
General machinery and apparatus	3.8	15.8	0.36
Electrical machinery and apparatus	14.7	42.6	0.98
Transportation machinery and equipment	4.2	68.7	1.58
Other manufacturing	5.5	75.4	1.74
Sub-total	207.0	1,217.8	28.05
Total	¥973.4	¥4,340.7	100.00%

SOURCE: Japan Development Bank, *Facts and Figures About the Japan Development Bank* (1981), p. 18.

GENERAL HEADQUARTERS
SUPREME COMMANDER FOR THE ALLIED POWERS
Civil Communications Section
Tel & Tel Division

12 May 1951

SUBJECT: Summary of Suggestions and Recommendations Made to MOTC by Tel & Tel Division

MEMORANDUM FOR: Record

1. Attached is a summary of some of the major recommendations and suggestions made by Tel & Tel engineers to the Ministry of Telecommunications for the purpose of improving the general communication system in Japan.

2. Early in the occupation the Tel & Tel Division of CCS was organized for the purpose of assisting the Japanese rehabilitating the wire communication system throughout Japan and in establishing a net work communication system for the use of the occupation forces.

3. For the first several years the efforts of the Tel & Tel Division were largely directed toward the reconstruction of war damaged properties and the provision of the communication needs of the occupation forces utilizing the facilities of the Japanese domestic system.

4. As this work of reconstruction neared completion it seemed desirable to reorganize the Ministry of Communications to separate the postal service from that of telecommunications in order to bring about the maximum improvement in telecommunication services. This reorganization was worked out jointly between CCS and the Japanese ministry. It became effective June 1, 1949.

5. During the planning of the reorganization and following its introduction CCS engineers made numerous inspections and surveys throughout Japan and the suggestions and recommendations attached are the result.

6. The memorandum attached outlines the conditions found and the suggestions which were made during discussions with the local forces in the field and in the form of memoranda for record. The purpose of the memorandum is to assemble these suggestions in a form to which reference can be made by the Japanese in their endeavors to carry out the recommended improvements.

Incl: a/s

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Telegraph Routing

In Japan at the present time the routing of long haul telegraph traffic is largely handled on a relay basis. Practically all telegraph lines are terminated in the larger telegraph offices of which Tokyo forms a center. With this method of routing almost any telegram that goes beyond one of the centers may have to be repeated, either manually or through printer service, in some cases as many as four times, before it reaches its destination. This method probably results in errors in transmission and in delay in reaching the destination.

CCS has suggested that MOTC consider the establishment of patching boards in the major centers so that any one of these centers can be connected through to any other major center and the message transmitted directly to the center nearest the final destination. This plan could be operated through the medium of order circuits between the several centers by means of which an operator in the originating center could reach a patching board in the next center and request that a connection be established to the terminating center. The patching board operator would then use an order wire to request a similar patching of the circuit at the next center, and so on until the terminating center is reached. The message would then be dispatched by the originating center and received directly by the terminating center which then would deliver the message to the addressed party or transmit it to the local telegraph office. This patching would be so developed that either hand sending or printer transmission could be used.

CCS suggests that this proposal be studied carefully and if found workable in Japan the necessary equipment and facilities could be developed and installed as finances would permit. It is thought that by the introduction of this method a decided improvement could be made in the speed and accuracy of telegraph service.

CCS also suggests that during this study the traffic volume between centers should be studied to determine whether permanent direct line assignments between non-adjacent centers could be justified. This would minimize the amount of patching and still further expedite deliveries.

Central Supply Procurement and Distribution

At the beginning of the occupation the obtaining of materials and supplies for rehabilitation purposes offered a serious problem. The electrical equipment manufacturers in Japan were able to produce only a limited amount of telecommunication materials and this was largely of their own design. Base materials were scarce and substitutes had to be used. Due to untrained personnel the workmanship and quality of the finished project was of a low standard.

The purchasing of materials within the Ministry of communications at that time was not centralized under one department. Each of the ten bureau areas maintained as many as ten warehouses, each of which purchased its own materials from manufacturers of their own choosing. This resulted in a complete lack of standardization of equipment or control of overstock quantities.

Considerable effort of CCS was devoted to improving the quality of materials and supplies and in assisting the manufacturers in rehabilitating their plants and improving the quality of the materials which were so urgently needed. The equipment manufacturers had to adjust their plants to meet the restricted post war market as they had vastly expanded them to meet the needs of the expanding Japanese empire. They had been furnishing most of the communication equipment for territory occupied by Japan prior to the war. During the war these expanded plants had been converted to war production almost entirely. With the occupation they had to adjust their output to the domestic requirements and what little export demand could be developed.

With the reorganization of MOTC in June 1949 a centralized supply purchasing and distribution agency was created known as the Supply Division of the Ministry of Telecommunications. Under the jurisdiction of this supply division 17 distributing warehouses and 21 repair shops were established geographically spaced throughout Japan. Each of these was under the direction of a chief who was a part of the supply division organization at MOTC. Each warehouse and each repair shop were assigned a specific geographical area which they were to serve.

The procurement of materials for stocks in the warehouses and repair shops was established on a requisition basis whereby they would order their requirements from the supply division at ministry level. The supply division people in turn would procure materials under bulk quantity contracts for direct shipments from the manufacturers to the respective warehouses and shops. Only minor items which are not a basic part of the operating plant were to be purchased locally by the respective warehouses and repair shops. This was a long step forward toward the ultimate standardization of communication materials in Japan.

A requisition system was also established whereby the wire chiefs, construction forces and engineers would obtain all of their material requirements through the supply division warehouses in such quantities and on such dates as they specified on their requisitions. The old system of automatic distribution in which the material was allotted to the operating forces on the basis of the number of subscribers, size of budget, proposed future construction projects, etc., was completely eliminated. The net result was the availability of material in types and quantities as required for the operating forces and a full control over shortages and overstocks in their storerooms.

This system of supply distribution made it possible to eliminate approximately 250 separate warehouses which previously had operated throughout Japan and a corresponding reduction in the number of repair shops. As railroads and highways become improved in the future it should be possible to effect a still further reduction in the number of warehouses and repair shops.

The establishment of 21 repair shops as a part of the supply organization was for the purpose of relieving the field forces of all damaged and unusable material from their storerooms and placing the repair of materials in the hands of experts on a specialized basis. The responsibility of the maintenance forces for repair work was confined to rub-up work and minor adjustments.

All material returned to the repair shop for repairs are transferred to the supply division account and when repairs have been completed the items are placed in regular distributing warehouse stocks as supply division property and are issued again on any requisition the same as new materials.

This system of supply procurement, distribution and repair was recommended by CCS which assisted in many ways in establishing it throughout Japan. Many visits were made to warehouse locations in all bureaus by the CCS advisor who helped to work out the details and to explain the plans in the field.

Many suggestions and recommendations have been made concerning the operations of the Supply Division and its components that, when fully put into effect, will result in improving the efficiency of their operations. The following suggestions on which action is not yet completed have been discussed with the Supply Division.

Specifications

It has been recommended that every effort be made to have ECL and the plant engineers prepare as rapidly as possible manufacturing specifications for all main items of equipment and supplies used in the telecommunication enterprise. This is necessary in the interest of standardization and to make it possible to follow competitive bidding procedures.

Procurement of Minor Items

For a number of years minor replacement parts and minor items of equipment have been purchased locally in almost every operating exchange. If certain screws were needed of a special type they were ordered from a local machine shop and manufactured by hand. Small repair parts were ordered similarly from samples. This was an expensive method of obtaining repair parts and also resulted in a very poor quality of the parts. CCS has strongly advocated that all repair parts or replacement parts be purchased in bulk from the manufacturer of the original equipment. There appeared to be considerable opposition on the part of the purchasing people to this suggestion. Apparently many small manufacturers throughout Japan have been supported to a great extent by the local purchase of these standard items by ECTC. CCS has repeatedly pointed out the fact that no inspection can be effectively carried out when repair parts are bought from hundreds of small irresponsible manufacturers all over Japan and without specifications.

Warehouse Stocks and Forecasting Requirements

As suggested by CCS the various warehouses throughout Japan have established a historical record of material shipped to the operating forces. This historical information is used as a basis for forecasting future requirements and for quarterly requisitions for replenishing stocks in the warehouses. The construction materials as determined by the projects that are included in the construction and installation budget can only be forecast by the engineering department of ECTC, and cannot always be accurately determined until after final approval of the budget. Most of the material required for construction, especially central office and repeater equipment, requires from 3 months to a year manufacturing interval. Therefore, it is very important that the Supply Division be informed at the earliest possible moment of firm and definite requirements for construction material. This is necessary so that negotiated contracts can be worked out in time for scheduled delivery dates. These plans have been discussed jointly with the plant engineer and the accounts and finance bureau at ECTC and a program has been developed whereby the engineers would provide the Supply Division with firm requirements on a quarterly basis from 3 months to one year in advance of the delivery date.

Disposition of Su[illegible] [illegible]nstruction Material

With the establ[illegible] [illegible]he warehouses throughout Japan and the consolidation [illegible] the [illegible]s and supplies held in the various storerooms it was [illegible]nd [illegible] was a sizeable amount of major units of construction [illegible] apparently had been ordered for some project which [illegible]n or other had not been approved. Most of thi[illegible] equipment planned for use in central offices or tol[illegible] stations. CCS suggested that a complete inventory be made of this surplus construction material showing the location where stored, this inventory to be consolidated at Ministry level for all bureaus so that the plant engineers, who would be furnished copies, could plan to specify in their material lists that certain surplus materials should be used on the project involved. Requisitions and material lists would also be checked by the supply division to determine whether any of the surplus could be utilized in case the engineer has overlooked the use of this surplus material in the preparation of his plans. The surplus material in question represents an investment of approximately 700,000,000 yen. CCS has suggested that the construction and installation department, on the completion of a construction project, should dispose of the unused material by returning to the supply division warehouse, such material as cannot currently be used by the maintenance forces at the location where the project has been handled. The warehouse could then reissue the material or dispose of it otherwise.

District and Wire Chiefs' Storeroom Supplies

With the introduction of the warehouse distributing system, the district storerooms and wire chiefs' supplies were to be reduced to not more than a 3 month requirement for most items. The district storeroom was provided for the purpose of storing material to be used by the district minor construction crews. The wire chiefs' or office storerooms were designed for the storing of material for current maintenance and the day-to-day station installations. A maximum and minimum supply for maintenance requirements for various size offices has been prepared. Therefore the quantities of the various items of materials in the storerooms should not exceed at any time more than sufficient for a 3 month period.

Surveys made by CCS indicate very clearly that in most cases both the district and wire chiefs storerooms are carrying an excessive amount of material. It has also been noted that some of the items which seem to be in excess of the needs represent material which may have been left there on the completion of a construction project and never transferred. CCS has suggested that a complete inventory be made of the supplies on hand in the operating force storerooms, both district and wire chiefs', and that any material that cannot be used currently should be transferred to supply division warehouses. In many cases short pieces of cable and even toll cable are found to be in local storerooms. It has been estimated that there is more than 2,000,000,000 yen of material in storeroom stocks a large portion of which represents an overstock. With present scarcity of base materials all supplies not currently required should be returned to the supply division warehouses where unusable materials can be disposed of and critical metals recovered.

Annual Inventory of Supplies

The intent of an annual inventory is to bring the accounting records into balance with the physical stock of material on hand. An adjustment should always be made annually to reflect the true figures of value and quantities of material on hand at the beginning of each fiscal year. It is the understanding of CCS that such inventories have not been taken by MOTC for a number of years, consequently the book records are not in agreement with the physical stocks on hand.

It has been recommended by CCS that an annual inventory be taken by the supply division as of the first of April each year and all accounting and stock record books be changed to agree with that inventory. In line with this recommendation an inventory was taken last year but no adjustment were made in either stock or accounting records so that no benefits were derived from the inventory.

It was stated to CCS that there has in the past been a fear in the minds of those responsible for the storage of materials that they might be subject to imprisonment if any discrepancy were to be discovered between the physical stocks and their book records. As a result, apparently, the inventory taken last year very strangely agreed exactly with the stock records.

It is only natural that in any business in which large amounts of material must be received, handled, shipped and numerous records maintained, it is physically impossible to eliminate errors during a full years operations. The Auditing Bureau people must surely recognize this fact and it is hard to believe that they would institute criminal action against anyone whose records indicated minor differences from an inventory. It has been recommended by CCS that meetings be held with the Auditing Bureau and the Supply Division chiefs so that an understanding on this matter can be reached that will allay any fears on the part of people responsible for materials. Until such fears are eliminated it will not be possible to obtain a correct and true inventory of supply stocks at any location within MOTC. This does not, however, eliminate the responsibility of preventing excessive losses of material due to fire, theft and negligence since most of these hazards are controllable.

Warehouse Material Handling

It seems to be common practice at supply division warehouses to make contracts with private companies for the packing and shipping of materials being sent to the field forces. The selecting and packing of material is a direct responsibility of warehouse personnel and should be performed by them. It has been recommended by CCS that all handling and packing of material for shipment be performed by regular supply division warehouse personnel.

Assignments of Personnel

During many visits made by CCS to supply division warehouses it was observed that the ratio of non-productive to productive labor was completely out of proportion. There is a great excess in the number of non-productive people which it is difficult to justify. For example, it was found at one location that 12 men were being used daily to post receipts and shipments to stock record books but an analysis by a CCS representative of the actual amount of work being done could have been performed by one man in 4 hours each day. This is a typical example of conditions uncovered in all locations visited, and other departments and sections were found to be similarly overstaffed. It was recommended by CCS that the supply division section chiefs conduct surveys and make analyses of the operations within their respective sections so that the amount of non-productive personnel could be greatly reduced. It was also recommended that the work being done by such employees be analyzed with the intention of simplifying the operations and eliminating non-essential work which would allow still further reductions of non-productive personnel.

With regard to the productive personnel in the warehouses and repair shops it has been noted by CCS that much wasted effort results from poor layout, inadequate lighting, unnecessary operations, etc., and it was recommended that analyses of operations also be made by the respective supervisors so that greater performance can be realized from the existing personnel or their number reduced.

Procurement and Production of Communication Equipment

In Japan all of the communication equipment is manufactured by privately owned companies. The telecommunications enterprise is a State monopoly and as such is the major domestic customer of these manufacturers. Therefore the existence of these manufacturers in the communication field depends largely on orders received from the supply division of MCTC. MCTC as a government agency is vitally interested in the overall economy of Japan and therefore an attempt is made to distribute its communication equipment needs among all of these companies. Therefore the economics that might be realized by mass production are not obtained. For example, when improvement in the design of major items of equipment is found necessary, all companies involved have to go to the expense of tooling up their manufacturing processes to meet the revised specifications. This situation occurred when the new improved #4 telephone set was standardized. Not only was the design of the housing and hand set changed but the capsule type of transmitter and receiver was introduced and the electrical and physical characteristics of the other parts of the set were completely changed.

Under the present financial conditions in Japan MOTC's requirements for the new type of set will probably be about 400,000 a year. At the present time there are four manufacturing companies equipped to produce this set but other companies are preparing to produce it also. MOTC is now purchasing telephone sets from more than seven manufacturers and if all of these companies make the necessary adjustments in manufacturing processes they will expect to continue to receive orders for telephone sets of the new type. It will be readily seen that with the limited volume of requirements and distribution of orders among so many manufacturers no one company will be in a position to apply mass production techniques effectively in this field.

CCS suggests that MOTC, together with the manufacturers, study carefully the current and future needs of the domestic telecommunication enterprise and work toward specialization by the various companies in the manufacturing of the many items of communications equipment. Certain manufacturers for example should consider specializing on dial central office equipment, others on manual central office needs and PBX switchboard still others on equipment used at subscribers' premises such as telephone sets, plan wiring equipment, etc.

It is understood that a reason for the present system of ordering the same equipment items from many manufacturers is to guard against possible interruption of supplies due to calamities such as earthquakes, typhoons, fire, etc. It is the opinion of CCS that the number of suppliers of each item of equipment could be drastically reduced without unduly sacrificing protection of the sources of supplies.

If specialization is introduced a more adequate manufacturer's inspecting system can be developed which should bring about improvement in the quality of the product produced. Specialization would also permit more comprehensive acceptance tests and inspections as made by MOTC Inspection Section representatives. Furthermore the needs of the various manufacturers for critical materials can more readily be determined under the specialization plan.

It is evident that if Japan is to keep abreast of developments in the communication field it will be necessary to make frequent changes in equipment design and these can be more readily and economically made with production on a specialization basis.

CCS fully realized that a change of the nature suggested in the relations of MOTC with the manufacturers of telecommunication equipment would have to be a gradual one and might require considerable time. It is firmly believed by CCS however that the advantages to be derived would be important in the development of the best telecommunication service for Japan.

Purchase of Non-Standard Communication Equipment

In Japan there are many high pressure individual salesman who are supposed to represent makers of communication equipment. Many of these salesmen have political support through which they obtain letters of introduction and requests from high ranking political officials that government agencies give them some business. Certain sums of money are allotted to the various sections of MOTC for the purchase of equipment to carry on their work. This allotment is taken from the profit and loss budget and the section is thereby authorized to make expenditures as they see fit so long as they stay within the amount of money allotted to them. The sales agents, therefore, are able to sell in many cases non-standard equipment which is used in operations such as training, or for testing of equipment. Many high priced test sets have been purchased through this method.

The uncontrolled purchase of portable test sets in the past has resulted in an excessive number of these sets of various types being distributed throughout Japan. In many cases the sets have been assigned to locations where there is little if any use for the sets. CCS has suggested that before additional test sets are purchased a canvass should be made of sets now available that are not being used. This surplus should be utilized to fill any current needs of additional sets. Any purchases of new sets should be definitely under the control of the plant department at Ministry level.

Also, recently 500 training switchboards were purchased from a small manufacturing concern which designed and assembled the boards from piece parts ordered from other manufacturers. These boards were shipped to the various exchanges throughout Japan but were never capitalized as a part of the physical plant. They were charged as an expense item. Most of this equipment was obtained without the preparation of specifications by ECL and was never approved by the Plant Engineer of MOTC.

Chairman GIBBONS. Mr. Tanaka, we appreciate your coming and helping us with this problem. You are right to point out, and I hope you are wrong in your prediction, that Canada, the United Kingdom, France, Italy, and all these countries are going more heavily socialistic and they are nationalizing many of their industries.

That worries me because, as you know, they are our allies and they are our best customers, and I am afraid they are going to go broke. I hope we do not follow their trend. We would like to have somebody we can sell to who is not going that way. They seem to be dividing up what is left over and operating very inefficiently and excluding competition from their market, and just gradually going broke.

I get very concerned when I go to meet with the Europeans about security matters, not because they are not fine friends and not because they cannot be good soldiers, but I do not think they are going to have the economic base to sustain their operation.

Mr. TANAKA. Yes, Mr. Chairman. The United Kingdom and Japan present two different styles of government involvement in the private sector. The Japanese Government generally stays out of taking over any companies. The one major public enterprise that the Japanese Government does operate is the Japan National Railways which has posted deficits in the area of $6 billion over a long time. So this is a good example of why the Japanese Government does not want to create any additional public corporations in which it would have an equity interest.

The British Government, I think, illustrates a case where it fell into, or was forced into, circumstances where it had to intervene to take over the operation of the steel mills by reason of default of private management, or private management's inability to put the British steel industry on a paying basis.

In contrast, France has affirmatively gone ahead with state enterprise capitalism and is methodically taking over company after company, starting with the telecommunications industry and followed by other high-tech industries. As a matter of fact, some of the U.S. companies such as ITT and others have experienced nationalization of their manufacturing operations in France.

Now, West Germany is closer. It has a government industrial policy closer to the Japanese style of industrial policy in the sense that the German Government tries to stay out of taking an equity interest in companies, but is currently heavily subsidizing its high-tech area.

Chairman GIBBONS. Let me get back to some trade problems. You represent the Electronic Industries Association of Japan here in Washington through your law firm.

Mr. TANAKA. Yes, sir.

Chairman GIBBONS. So you must have a lot of experience in the problems that any importer has.

Mr. TANAKA. Yes.

Chairman GIBBONS. Do we exclude any of your electronic products from your market?

Mr. TANAKA. Would you repeat that, sir?

Chairman GIBBONS. Do we exclude any of your electronic products from our market? Are there any quotas or discriminatory tariffs that are higher than Japanese tariffs on the same product? Are we excluding any of your products from our market?

Mr. TANAKA. No. There are, of course—There is the Buy American Act and the Government Procurement Code. That does not cover State and local procurement and so on. There are these buy American provisions. So the Government Procurement Code and the GATT only covers Federal Government procurement.

But otherwise this market obviously is one of the freest. I think if there is any criticism with it, I think there are two. The first is that there is one view that has been expressed in Japan that there is a considerably high level of what is known as legal harassment, which constitutes a nontariff barrier of sorts. Oftentimes over the years, particularly in electronic products, there have been at least 40 import restriction actions taken, none of which have really turned out to be effective in excluding imports.

Again, the reason is not because the laws are ineffective, but rather because we live in a technology-driven society where products are rapidly changing, so that costs change when the technology input becomes higher and scale economies can be more effectively captured. That means that the unit costs go down. As a result, many of the imports from Japan come in without having any problems with the antidumping law, for example.

Chairman GIBBONS. Let me ask you another. Do we in the United States require any kind of inspection on the dock of Japanese products when they come in, other than perhaps counting them, something like that? Do we inspect them for compliance with our codes or do they come in with manufacturer certification?

Mr. TANAKA. Yes; that is a good point, Mr. Chairman. We follow the self-certification system where the product is subject to some government standards, whether it be a food standard or a safety standard relating to automobiles or radiation levels relating to TV sets. We follow the self-certification standards and the Japanese Government practice, as I understand it, is one of not permitting self-certification. So the net result is that American exports are stopped at the port to undergo inspection.

Chairman GIBBONS. I did not know that. Is that in electronics goods, too?

Mr. TANAKA. No, not in electronic goods. These are other goods.

Chairman GIBBONS. In automobiles they do that, of course.

Mr. TANAKA. That is right.

Chairman GIBBONS. I do not know what other products. I just know of automobiles.

There are reports coming to me that about 70 percent of American products going into Japan have to be inspected on the docks and have to meet high standards. Products from Japan in this market come in under dealer certification, which is our customary way of dealing with all of our trading partners.

Has your Association ever brought this matter to the attention of the Japanese Government?

Mr. TANAKA. There are none with respect to electronic products.

Chairman GIBBONS. Electronic products go in. We do not ship many electronic parts over there, do we? I know you probably see more of them coming this way than going over.

Mr. TANAKA. That is true. But there is substantial export of semiconductors and other measuring or test instruments which have a fairly high electronic content.

Chairman GIBBONS. I was just looking over the 1983 report for 1982 and previous years of the major items, the leading items that come into this country from Japan and go out from this country to Japan, and I did not find very many electronic items on here. But I realize in any classification that is as difficult as in these tariff schedules it is pretty hard to spot them.

But it seems to me that all we really export to you of manufactured items are a few aircraft and aircraft parts, some digital central processing units, some nuclear reactors—excuse me. That is fuel, not reactors. There is an awful lot of coal, soybeans, wheat, cotton, logs, unwrought aluminum, natural gas, hemlock logs—these are all the major items—tobacco filler, beef carcasses, sockeye red salmon, cattle hides whole, wood chips, sorghum, bituminous coal, fuel oils, and copper ore.

Whereas when you turn to the flip side of this chart of the major items coming in, it is all very high value added equipment, all the things that we would like to make and cannot compete with for some reason or another. I think therein lies one of the sources of irritation about our trade, and it is the major reason why we had last year about a $17 billion merchandise trade deficit with you.

Now, I realize that we should not look at trade just on a bilateral basis, we ought to look at it on a worldwide basis. On a worldwide basis we do pretty well.

Mr. TANAKA. Yes.

Chairman GIBBONS. In fact, last year was the first year in a long, long time in which we have had a deficit on a worldwide basis. It was principally because our economy was down, but it was not down as far as everybody else's economy. We lost customers. We even lost customers in your country, and by your country I mean Japan. I realize that you are an American citizen. That is a slip of the tongue.

But we have some problems we have to solve here and I am hopeful that associations like yours will take back to the Japanese Government and to other Japanese industries that we do seek reciprocity on access. If we could remove all the access problems and get the yen-dollar value ratio straightened out, I am not predicting that all of our frictions would go away, but I do not think we would have any reasonable grounds on which to protest.

Mr. TANAKA. Mr. Chairman, I think that one of our problems in bilateral economic relations is this inordinate fixation on the bilateral merchandise trade, and my view is that the skewed, the terribly skewed bilateral merchandise trade does not necessarily reflect the relative competitiveness in the aggregate of the two economies.

The bilateral merchandise trade does not include the sales and the profits which American-based multinational corporations make in trade through third countries. The classic example is oil. Japan imports 99 percent or 99.8 percent of its oil. Now, the Seven Sister companies and U.S. majors have a major share in the sale of oil to Japan through third countries, and that sale and the profits earn as a result of that sale made through third countries is not reflected in bilateral merchandise trade.

Third, there are American-owned businesses in Japan making substantial sales in the Japanese market. This is not reflected in the bilateral merchandise trade. We must remember that the American economy has long since burst its national borders and has become multinational.

If you perceive that the American economy's spread is multinational, I think you have to look to what American business is doing through third countries with Japan and see how they size up competitively. There are various dimensions, I think, in relations both direct and indirect between the United States and Japan, and bilateral merchandise trade is only one indicator by which to view or measure relative competitiveness.

As opposed to merchandise trade, we have huge service sector profits, royalties and so forth. All of this has in the 1970's, for the most part, offset the merchandise trade deficits.

So America's real growth area in international business is not merchandise trade, and I think the reasons are obvious: that our style of doing business abroad is to serve the foreign market from within by setting up factories locally. So this has a certain inhibiting effect on U.S. exports.

For example, IBM has a computer plant in Japan from which IBM can serve the Japanese market. NCR has a computer plant in Japan from which it can serve the Japanese market. So NCR and IBM do not export to Japan substantial quantities of computers.

So you have all of these things. I think it is a very complicated and complex picture. But when one bears in mind that the American national economy has a multinational spread then you begin to see the complexity of relationships that really exist between the American economy and other economies. This relationship will become increasingly complex as all industrial powers become increasingly interdependent.

Chairman GIBBONS. What you are saying is that a part of our problem is caused by our measuring system.

Mr. TANAKA. Yes, sir.

Chairman GIBBONS. I will have to admit there is something to that, but even in the services side, coming back directly from Japan, services amount to only about $2 billion. That would reflect profits and things of that sort and still would not reduce our total deficit more than about from $17 billion to around $15 billion.

So we still have some problems there, and I realize some of it comes back indirectly, like the Seven Sisters come back indirectly, although we are not real sure who the Seven Sisters belong to. We know they have headquarters here, but we are no sure what their parentage is or what their ownership is.

Thank you, Mr. Tanaka.

Mr. Jenkins.

Mr. JENKINS. Thank you, Mr. Chairman.

Mr. Tanaka, I appreciate your testimony. I do want to ask one thing since you were here and listened to some of the other witnesses. There seemed to be a general consensus with most of the other witnesses that there is definitely an imbalance in the exchange rate at the present time. Is that your general view also, that the yen is undervalued?

Mr. TANAKA. Yes, the yen is undervalued in relation to the dollar, unquestionably.

Mr. JENKINS. Two or three of the other witnesses seemed to think that that was the greatest problem that we faced at the present time. As a matter of fact, the witness from the Roundtable, I believe, indicated certain unilateral steps that we could take to help strengthen the yen, but that we could not do it totally unilaterally.

Do you see anything down the immediate horizon that Japan might do to bring that in better balance?

Mr. TANAKA. Well, I think, as was pointed out this morning, the same concerns are being expressed by Japanese businessmen, particularly those who are involved in a big way in international business, that the stability of the currency conversion rates are essential to the orderly conduct of business.

Accordingly, there is pressure growing within the Japanese business groups to ask the Japanese Government to establish some sort of targeted levels within which to seek a stabilization of the currency.

Unfortunately, I think my view is that the psychology of the investors has so much to do with, and perceptions play a major role in the value of the currencies in a free-floating situation that the governments, either individually or collectively, really cannot regulate.

Mr. JENKINS. If they cannot regulate the rate, the Government could cease to keep the currency rate in an insulated situation which a couple of the witnesses indicated the yen has been insulated by governmental actions, with artificial restrictions on interest rates and other factors that tend to keep the value down.

Mr. TANAKA. As an earlier speaker pointed out, the capital controls were relaxed under pressure from the United States, among other countries, and unfortunately the timing was poor, so that there was an outflow of yen as a result of that action, with the yen holders seeking the coincident higher interest rates, in the United States. So the higher interest rates in the United States obviously play a role in the depreciation of the yen.

There are a number, I think, of complex factors which play a role in addition to the perception of investors. But if governments can discuss this matter more directly, with an idea to promoting the stability of currency values, this could psychologically have a very salutary effect of stabilizing the currency values within levels which would be manageable.

Mr. JENKINS. Most of the witnesses also indicated that they were opposed to domestic content type legislation, and I am sure that your clients are likewise opposed to domestic content legislation. But let me ask you this: Are you familiar with the fact that Japan itself has domestic content practices, whether by regulation or legislation, particularly in the airline situation?

I have read of some of the contracts that were entered into 3 or 4 years ago that required a certain portion of that contract for aircraft to be manufactured in Japan. Are you familiar with that?

Mr. **Tanaka**. Well, generally yes. I think the genesis was that at one time, more than a decade ago, when the U.S. aircraft companies were filled up with back orders, the aircraft manufacturers themselves suggested to the Japanese aircraft people to supply some of the subassemblies. There was a time when the bays of the American aircraft manufacturers were so loaded up that there was no additional capacity in this country, and that eventually evolved into a situation where the foreign manufacturer now want a certain percentage reserved for coproduction with the American aircraft manufacturers.

But I do not think that this requirement is limited to the Japanese. I think some of the other countries which purchase American aircraft now have similar requirements.

Mr. **Jenkins**. So there are a lot of countries that do have domestic content requirements?

Mr. **Tanaka**. Particularly developing countries have domestic content requirement on a long spectrum of goods.

Mr. **Jenkins**. Thank you very much.

Chairman **Gibbons**. Mr. Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman.

Mr. Tanaka, I appreciated your presentation. If the view of many in this country that Japanese trade and pricing and penetration practices are predatory is incorrect or perhaps misguided, why is it that as I travel around the world the Japanese have that reputation in many other places in the world? It is not only the view here, but many other countries.

I keep getting that message, I can tell you in all candor, from some trade ministers of other nations, who have said that if we can absolutely avoid it, we try not to do business with you.

Mr. **Tanaka**. Because of the proclivity of Japanese businessmen to engage in predatory practices?

Mr. **Schulze**. Well, I am saying if these are just normal practices, why is it this reputation? I do not see it only in the United States. If it were only here, I might question it, but I see it in many other parts of the world. Why do you think that that is—do you think that is not a well-deserved reputation or an incorrect perception?

Mr. **Tanaka**. Well, I think it is perceptional in part. I think part of it is adversarial rhetoric and it may have been partially true. There have been affirmative injury determinations, for example, made under American laws with respect to imports from Japan. I do not think that the Japanese businessman is any more moral than any other businessman.

Perhaps he has done a little better. I think that when one looks at the relative levels of success achieved by industrial policy or by nationalization in various countries, you will find that when looking at the results, the Japanese have done a little better. They are more competitive.

I think the answer is that while many countries preach competition as the most important ethos, many of the people do not practice it. For example, in the United States there are various techniques used to avoid competition, to compete on every other basis but price. This psychology, I think, is prevalent worldwide, particularly when the pie is shrinking during a recessionary period.

One is apt to criticize the business practices of others who appear to be a little bit more successful, but fundamentally the matter of predatory pricing is a legal question and what I think is the problem is that the Europeans and Americans, who are steeped in legal tradition, look at issues in an adversarial light, and tend to look at the legal effect of practices instead of looking at the more fundamental processes that are at work in the economy.

That is the technology-driven process of constant change—disinvestment out of low growth industries into high growth industries. This is a process that is going on all along, and unless businessmen keep up and ride the crest of this technology-driven process of creative destruction, those businessmen are just going to lose out in competition.

So I do not think that all of this rhetoric about Japanese predatory practices necessarily is accurate. There is no question that they are hard businessmen.

Mr. SCHULZE. I guess I am just stating it, perhaps that you could send a message back that there is a widespread perception, whether it is accurate or not, and it seems to me to be growing and one of the examples that comes to my mind when you talk about cultural differences in the heavy motorcycle area, where loading up of inventories in this country and then the pressure to sell through the retailers where you are actually using some of the producers and shippers are using our historic merchandising methods to gain their own ends and push our domestic producers out of the business.

I do not have an awful lot of sympathy with cultural differences with that argument being thrown up when I see people, granted in a very astute merchandising method, but by using our cultural historic merchandising practices to dominate or penetrate a market and destroy our domestic producers. That does not invoke a great deal of sympathy in me for the cry of we have different cultures over here and, therefore, you cannot merchandise things the way that you want.

Mr. TANAKA. Well, my view is that the difference in the competitive edge is largely not a reflection of cultural differences.

Mr. SCHULZE. Yes. Having been in the retail business and I guess right now I am honing in on that heavy motorcycle situation which I presume you are aware of, it seems to me to be very easy to do what was done. It is not a very good merchandising technique, but it is a merchandising technique, where you load up a dealer or a distributor and keep the pressure on. You know, you have just got to move them out at any cost, and apparently that was what was done.

From what you said about targeting, your response seems to be that we should fight targeting with targeting, that we should change our antitrust laws a little bit and that we should turn that around like a laser and concentrate and get into the targeting business. Did I hear you correctly?

Mr. TANAKA. No. I think that the first point is that we ought to be aware of what is going on overseas, both in Japan as well as north of us in Canada and Europe and various countries where different techniques are being used to promote economic growth within their borders. Certainly this country would be remiss if it did not take measures to promote the economic growth of this country and the most cost-effective allocation of its resources.

How you do it in this country is really the problem, but when you look at American priorities you find, for example, that the semiconductor industry people have complained about capital shortages. If you look at 1978 and 1979, you find that our total capital investment, one-third of capital investment goes into housing. That is a result of interest cost offset given to the mortgage holder against taxable income. This has a targeted effect of promoting housing and demoting, in effect, the importance of, let's say, capital availability to the high-tech industries.

Second, American-based banks, for example, have loaned $200 billion or more abroad to developing countries. This takes capital away from the high-tech industries. So every action that the Government takes or does not take has an impact on the private sector.

To categorize any particular set of devices as industrial targeting serves, I think, is to confuse rather than to clarify the issues, so we have practiced targeting, as the chairman has said this morning, with respect to agriculture, and consequently we have the most efficient agricultural industry in the world.

Now if the overseas effect of the U.S. agricultural targeting is culpable, the United States is no more culpable than Japan with its targeting practices in the high-tech industries. So you can go on discussing this, but the focus should be what are the devices and mechanisms that this country ought to use consistent with its philosophy and democratic scheme of Government that would more effectively motivate and promote economic growth. Economic growth, I think, ultimately is a matter of people management.

The managers in this country have been too concerned with fixed assets management and disregarded management of people, and considered people as costs rather than assets. I think that certainly this Congress ought to look at the American people as an asset because people ultimately are the only value-creating factor of production. Equipment is not, unless you have people operating it.

So I think it is how one marshals the people in one's country, and how they relate to each other, that really builds in inflationary cost biases or builds in cost efficiencies.

Mr. SCHULZE. Mr. Tanaka, I personally believe that the Japanese experience will go down as a case study in how selective protectionism can be used to build an economy. Perhaps we have some lessons to learn from that.

Mr. TANAKA. Yes, in the sense that it will provide additional insights on how we can proceed to develop our own techniques and institutional arrangements calculated to increase the economic growth and cost competitiveness of this economy in the aggregate.

Mr. SCHULZE. One final thing. I think the people whom you represent, the electronic industries, should try to send a very strong message to the Government because if we do take some protectionist measures, and I think perhaps the chairman was alluding to one that I have heard discussed—to have some sort of a reciprocity inspection system—it would be very economical for us to put on an additional 50 customs inspectors and say inspect all of those. You know, it would take months to have it inspected, and we would just say gosh, I am sorry, we do not have any money for more inspectors. We are doing it as rapidly as we can.

I think the industries you represent probably would be impacted in a negative way by those types of actions and, as a consequence, you have more to lose than anybody else and I would urge you strongly to send that message and clear up some of those nontariff barriers.

I realize sometimes they are more emotional than actual, but the perception is there and I would urge you to have them take that action and see if we cannot get rid of some of those negative interferences between our nations.

Mr. TANAKA. Yes. We have already in the past—you are absolutely correct. I endorse that. Yes, it could have an adverse effect on my clients and we will continue to send that message.

Mr. SCHULZE. Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Mr. Tanaka.

Mr. TANAKA. Thank you, Mr. Chairman.

Chairman GIBBONS. Our next witness is from Houdaille Industries, Inc., Mr. John Latona.

Mr. SCHULZE. Mr. Chairman, if I may, I do have to run, but I would like to welcome Mr. Latona on behalf of Mr. Conable, who had hoped to be here to welcome you and say a few kind words. He is tied up and unable to be here and we are very sympathetic. In fact, I guess from my point of view I think you are on the right track. We welcome you to the committee.

STATEMENT OF JOHN LATONA, VICE PRESIDENT, LAW AND CORPORATE SECRETARY, HOUDAILLE INDUSTRIES, INC., ACCOMPANIED BY RICHARD COPAKEN, ESQ., COVINGTON & BURLING

Mr. LATONA. Thank you for those kind words and I thank Mr. Conable also.

Chairman GIBBONS. We are sorry Mr. Conable cannot be here. He is an extremely busy man.

Mr. LATONA. Thank you, Mr. Chairman, for giving us this opportunity. I am John Latona, vice president of Houdaille Industries. We are headquartered in Fort Lauderdale, Fla. We make machine tools in New York State, Minnesota, California, Tennessee, and Michigan. I have with me Richard Copaken of the law firm of Covington & Burling, who has assisted us in our venture.

We are filing a statement, which you have——

Chairman GIBBONS. He has done an excellent research job. I have not read all the material that he has unearthed, but it was an excellent job of research.

Mr. LATONA. It runs ahead of all of us in terms of trying to keep up with the number of pages.

We are filing a statement which is a review of our experiences since filing our petition under section 103 of the Revenue Act of 1971. I would suggest to anyone who really wants to get the whole story that they read the petition and the documents that followed after it that have been submitted to the U.S. Trade Representative's office.

Chairman GIBBONS. Let me say it is not light, afterdinner reading.

Mr. Latona. No, it is not. I would say, though, that some of it is in Japanese and so, therefore, most of us can skip over that part anyway. We do have translations.

Chairman Gibbons. No wonder I was having so much trouble with it.

Mr. Latona. We do have translations for everything that is in Japanese, so some of the pages you can slip by pretty quickly. I would also suggest that the true devotee might want to take a look at the videotapes that Mr. Copaken has made both in Japan and now some in the United States.

We are a small, not so small but a private company fighting, we feel, the Japanese Government. Our modern-day David, Mr. Copaken, does not use a sling. He uses a more contemporary weapon, a video camera, and I must say thus far the results have been almost as dramatic as they were in Biblical times. We hope that the ultimate outcome will be as dramatic.

I just want to speak about two particular issues that we want to emphasize today rather than go through the whole statement. One is we are dealing in our petition with the fundamental issue of fairness. We are one of the microproblems that Fred Bergsten spoke of, one of those industries, a slice of an industry that has suffered disproportionately from the fact that the Japanese Government has selected our product lines for special attention. And as a result, the Japanese manufacturers have taken over 60 percent of the market for machining centers in the Unite States, over 40 percent of the market for punching machines in the United States, in the brief period of time since 1976.

This is not competition. This is a monopoly. It is a Government-subsidizing monopoly. For a group of private U.S. companies, many of them quite small companies, many of them quite smaller than Houdaille, a few quite larger than Houdaille, to attempt to compete with a Government as large and as economically powerful as that of Japan is just simply impossible.

The second issue I would like to speak to is the question of how did this all come about. We hear a great deal in recent days, that it is just really a matter of the fact that the Japanese make better products. In our case, that the Japanese make better machine tools. I really would like to address that directly and with some emphasis.

The fact of the matter is of course that the Japanese do make good machine tools. They sell them at very competitive prices—sometimes, we think, better than competitive—but nevertheless quite competitive prices. They have excellent delivery records, excellent service. One would think this would not require mentioning. Obviously, if they were selling poor products at high prices with poor service, we would not be here, we would not have a complaint.

The question is not do these things exist, but how do they come about. No. 1, we say it comes about because efforts of the Government of Japan. The second thing, though, is what about the quality of U.S. machine tools? I have brought with me packages of materials describing Houdaille machine tools.

The fact of the matter is that not just Houdaille but all U.S. machine tool companies are at the very leading edge of machine tool technology in the world. There are no machine tools made in Japan that are not made, and in fact were not made first, in the United States. Virtually all Japanese machine tools are based on U.S. technology.

They do manufacture them quite well. But I want to emphasize that there is no superiority in the Japanese product or in the Japanese research facilities or anything else that has led them to an advantage that stems from producing something that it not produced here in the United States.

They merely have an advantage in that their Government supports their activities and our Government, quite properly, we feel, does not.

To be even more specific on this issue, historically it is pointed out that back in the late 1970's when the Japanese began their dramatic penetration of the U.S. machine tool market, that there were great backlogs of orders for machine tools in the United States, and it is this that enabled the Japanese to seize the large portion of the U.S. market.

Now, it is true that there were great backlogs, there were great demands for machine tools and there were great backlogs. Again, the question is how were these backlogs able to be filled so rapidly by the Japanese and no one else in the world? If the U.S. industry were so inferior, as some would have it, that that was the cause of this dramatic change, then why was it that only the Japanese increased their market share in the United States?

The fact is that the English, Germans, French, Italians, and many other countries, make very fine machine tools. They are good competitors. We lose sales to them on occasion. But none of them were able to take advantage of this alleged inferior position of the U.S. machine tool industry. Only the Japanese succeeded in expanding their market share during this period in such a dramatic form. Again, we submit, that was due directly to the efforts and the resources of the Japanese Government.

I think those were the two points I wanted to make, Mr. Chairman. We would obviously be more than happy to answer any questions on any facet of our petition or of what we have learned about the Japanese machine tool industry.

[The prepared statement follows:]

STATEMENT OF JOHN LATONA, VICE PRESIDENT-LAW, HOUDAILLE INDUSTRIES, INC.

Mr. Chairman, anyone wishing the full details of our description of unfair Japanese trade and industry targeting practices in the machine tool industry, should read the comprehensively documented petition we submitted to the President through the U.S. Trade Representative on May 3, 1982, and later submissions we made to the Trade Representative's office. In addition to the legal analysis of our position, they contain hundreds of pages of official Japanese government documents in the original and translation, describing the official creation of a Japanese machine tool cartel and the wide varity of financial assistance given the cartel by the Japanese Government. No one has challenged the veracity of those documents.

In addition, Mr. Copaken of our law firm, Covington & Burling, has made an extraordinarily revealing set of video tapes of his meetings with Japanese officials at technical research facilities funded and, in one case, operated by Japan's Ministry of International Trade and Industry. These tapes prove that our petition is not based on some legal abstraction. They depict in concrete terms what Japanese industry targeting means today.

My statement this morning will merely highlight our findings and describe some of our experiences as we have struggled to bring an element of equity to the fundamentally unfair battle between individual U.S. machine tool producers and the Government-backed machine tool cartel of Japan.

Article after article and expert after expert is telling manufacturers that we ought to be ashamed of ourselves for letting the Japanese beat us with their superior quality, better economics, improved technology, etc., all of which have occurred by virtute of their dedication to achievement, their system of lifetime employment, etc. To all of that, we say "phooey."

In industry after industry and particularly in that segment of the machine tool industry we are most interested in, we have found that Japanese achievements have resulted in large measure from very well organized, very well implemented plans initiated by their government to target penetration by its industry of world markets—especially the United States market because it is the world's largest.

We are a major manufacturer of technologically advanced computer controlled (NC) machining centers and punching machines. We have watched Japanese penetration in those two product lines soar miraculously from around the 4 percent range as recently as 1976 to approximately 60 percent and 46 percent, respectively, in the most recent period. We set out to determine how this was accomplished, for, if the trend continued unabated, the United States machine tool industry would fall mortally wounded before any action under the traditionally available trade laws could be taken.

Approximately 18 months ago we were becoming increasingly aware of the dramatic inroads being made by Japanese machine tool manufacturers in the U.S. marketplace. Conditions have since become far worse, intensified by the economic downturn, and felt most severely by capital goods manufacturers.

Phillip A. O'Reilly, President and Chief Executive Officer of Houdaille Industries, Inc., has long believed that the Investment Credit should be limited to U.S. value added. In discussing the possibility of legislation to accomplish this, Section 103 of the Revenue Act of 1971 was brought to our attention by Jim Mack of the National Machine Tool Builders' Association. Section 103 gives the President discretion to deny the Investment Credit to foreign goods where the foreign country has engaged in policies unfairly burdening U.S. commerce.

But why turn to Section 103, unused and unheralded, when other remedies ostensibly were available? Section 103 provides a very effective remedy with maximum administrative flexibility. Proceedings under Section 201 of the Trade Act of 1974 invariably take a very long time and many of those who proved their case under 201 still failed to obtain relief. Section 301 of the Trade Act of 1974 had been invoked a comparatively few times and, although some informal government-to-government settlements were achieved, no one had been granted relief under it. There is no need to go on. Anyone familiar with the field knows that in the past the deck has been stacked against U.S. businesses seeking equitable relief from unfair foreign governmental policies and practices. The road is long and arduous, the cost prohibitive and the outcome certain only in the sense that defeat is the greatest likelihood.

We therefore decided that invoking an unused statute might enable us to move more quickly, and achieve favorable results. We also felt that the unique nature of the remdey, and the breadth of the President's discretionary authority that, incidentally, had never been delegated to any agency and therefore was devoid of any red tape, surely made swift use of this statute possible and, we hoped, more likely.

Mr. Copaken determined that our case had to be firmly based on facts rather than conjecture or strong feelings. He and Mr. O'Reilly actually went to Japan and interviewed Japanese officials. The Japanese are forthcoming only if asked precisely the right question and only if precisely the right Japanese is asked. O'Reilly and Copaken scored some direct hits. Also essential to our findings were the efforts of a leading Japanese law firm we retained to analyze and translate Japanese laws and government orders for Mr. Copaken. The results of all these efforts are now on file with the Trade Representative's office: Chapter and verse on the creation and maintenance of the machine tool cartel by MITI and the subsidization of that cartel by a bewildering variety of loans, grants, tax concessions and the now-famous bicycle and motorcycle race betting funds.

The Japanese machine-tool cartel was formed in response to the first of a series of three special laws for the promotion of the machinery industry. In enacting these laws the Government of Japan launched an ambitious crusade to seize the higher value-added and most technologically advanced market segment of this fundamental industry. Although these laws were officially characterized as temporary measures, they have remained in effect since 1956—one "temporary" measure following on the heels of another.

The Japanese Ministry of International Trade and Industry ("MITI") used the free hand given to it by these laws to weed out manufacturers with small market shares. Each firm whose production constituted less than 5 percent of the Japanese market in a specific machine tool and less than 20 percent of the company's total enterprise was directed to stop manufacturing those tools. The market shares thereby relinquished were turned over to a limited number of larger, more successful producers. Under MITI's guidance these companies then exploited the consequent economies of scale and specialization to penetrate export markets, secure in the knowledge that these advantages would be protected against competitive erosion in the Japanese market.

In taking these actions the government of Japan catapulted its cartel into the high-technology end of the market. MITI successfully pressed the Japanese machine tool manufacturers to act jointly to concentrate their efforts in developing and producing NC machine tools. Each company in the cartel was directed by MITI to increase to 50 percent the NC share of its total production of machine tools. In addition, the cartel was directed to expand its collaborative efforts to include suppliers, customers, service, and other activities.

With the long-range goal of selectively penetrating and dominating important export markets as its guiding principle, the Government of Japan devised imaginative strategies for financing this cartel with tax advantages, concessionary loans, research grants, and other direct and indirect subsidies.

In the most unusual example, nearly a billion dollars a year worth of yen generated by wagering on bicycle and motorcycle races in Japan were and continued to be made available by MITI for promoting the Japanese machinery industry, including the machine tool cartel, and the export of these products.

MITI officials confirmed the government's use of this mechanism to support Japan's machinery industry including, specifically, the machine tool segment, but downplayed its importance by quantifying the bicycle racing proceeds subsidy at less then one-half million dollars a year. In preparing our Petition we relied on those assurances, although MITI would not provide documentation in spite of our repeatedly submitted written questions.

Their assurances turned out to be false. We now have official Japanese government and private documents which reveal that in the 1979 Japanese fiscal year, some 919 million dollars were made available from wagers on bicycle and motorcycle races alone to promote the Japanese machinery industry and in Japanese fiscal year 1980, 823 million dollars. This assumes a conversion rate of 201.3975 yen to the dollar in 1979 and 229.66 yen ot the dollar in 1980. In yen, the 1980 figure was actually 4 billion yen higher than in 1979. Those who manufacture other machinery products would do well to investigate how their Japanese competitors are benefitting from this annual largess.

The results of this targeting of the U.S. machine tool marketplace were dramatic. The Japanese now make over 50 percent of the sales in the high technology sectors of the business. Because of the government assistance they receive, members of the cartel offer U.S. buyers good products at competitive prices with quick delivery and quick service. We have demonstrated that these positive attributes are the result of massive government assistance, not superior engineering or management. Nevertheless, there are those in our country who do not look behind the Japanese products to see the role of government subsidy.

The facts are these: Japanese machine tools are not technologically superior to those made in the United States. In fact, virtually all Japanese machine tools are directly copied from U.S. designs obtained through licensing agreements or reverse engineering. At the direction of their government, Japanese manufacturers set out to obtain the best designs in the world. They found them in the United States.

Their ability to deliver stems from their large inventories of machines. United States manufacturers generally build to order and thus have longer lead times. It does not require a marketing genius to realize that having machines in inventory gives a seller a decided advantage with buyers. However, U.S. machine tool makers were simply unable to finance the huge costs of such inventories while the Japanese were because of government subsidies.

The same holds true for service. With government help it is possible to maintain larger staffs of service people than those employed by individual private companies. The bottom line is this: The competitive advantage developed by the Japanese following 1976 to the present was not the result of superior skill and effort, but the result of a cartel with a deep pocket, in this case, the pocket of the government of Japan.

We do not view our petition as protectionist in any sense. We believe in free trade. We are confident that in a fair fight we can compete with any private manufacturing concern. Competing with a government the size of Japan's is another matter. As long as it provides the extraordinary range of subsidies and direction as we have revealed, we see no free trade theory which justifies the U.S. allowing its manufacturers to lose business and its workers to lose jobs. The Houdaille Petition gives the President a rare opportunity to take an affirmative action for free trade by forcing the Japanese to moderate their practices to a more acceptable level of free and fair competition.

The detailed documentation of Japan's industrial policy that we have provided transforms our case from one of parochial concern into a major opportunity for enhancing the leverage of the United States to open Japanese markets and assure that United States industry and jobs are not lost to unfair cartel competition.

Despite years of talk, the Government of Japan continues to resist opening its markets in any significant way to free competition. Until the United States shifts from talk to action, it will always be so.

We began our project in the Fall of 1981, we filed our petition in May of 1982 and it is now March 1983. Where do we stand?

By the measure of our expections, we are further from our goal, leaner of visage and lighter of purse than we had hoped. By the measure of those who view the world from the Potomac, we are on the brink of success with a trail of eye-opening documents behind us. It is our understanding that the next few days will reveal if we will be ultimately successful.

By granting the Houdaille Petition, the President will send a message to Japan, the European Economic Community and our other trading partners that the President has an effective, practical weapon that could be used again in another context, if necessary. Such a message should lead to significant negotiating concessions across the broad spectrum of international trade concerns.

Granting our Petition will also send a message of hope to United States industry, labor, and individual United States citizens in these troubled times of deep recession and double digit unemployment that the President understands what is going on and will take action to correct the situation. The American people would welcome such action.

Failure to act would send a message to United States industry, labor and to the electorate that the United States is prepared to become an economic colony—exporting agricultural products and raw materials and importing high technology manufactured goods—with a consequent accelerating decrease in our standard of living and our national security.

This recital of the possible outcomes points to only one positive conclusion: The President must provide relief to the machine tool industry through the Houdaille Petition. A strong machine tool industry is essential to our national interest. We must take a stand for free and fair world trade.

Chairman GIBBONS. We will put your entire statement in the record.

Essentially, what did the Japanese do to put themselves at a competitive advantage? Just briefly.

Mr. LATONA. Well, they do several things, and of course some of them have been outlined here today. Once it is decided by, as I understand it, a consensus of government and business leaders in Japan, that a certain type of product is to get special attention, the market for that product, if not already closed in Japan, is closed. This enables the domestic manufacturers to start building in a protected environment. If need be, the technology is acquired from overseas through licensing agreements. We see this still going on to this day in robotics. I think it is probably happening literally right this minute with airplanes.

This protected environment gives them several advantages. It enables them to develop the expertise to utilize the so-called learning curve, that the business school theorists speak about. It allows them to build up financial resources.

It enables them to have a large enough volume. They are not only able to reduce the price on the basis of the volume advantage, but can, because of what we understand are the social policies of the Japanese Government to maintain full employment, overproduce, and then they are able to sell products overseas on a marginal cost basis rather than a total cost basis, secure in the knowledge that they are financially backed by the Japanese Government.

Once they go overseas, these advantages continue, including special financing arrangements, special tax arrangements. We have evidence that less successful producers are forced out of the marketplace and their market share allocated to more successful producers. This again prevents anybody from nipping at the financial heels of the domestic producers that are deemed to be the ones that will lead the charge overseas.

Loans are made available for additional research. Loans are made available for export financing. One example of this—and again we go back to the question of backlogs and the rapid delivery—machine tools are expensive. The ones we are talking about run anywhere from $100,000 to $250,000, or $350,000.

It does not require any kind of a marketing genius to know that if one could stockpile, if one could inventory such machines, one would have a great advantage in the marketplace. A customer walks in and says, I would like such-and-such a machine. We say, fine, we have it right here, we will send it right over.

American companies, particularly in the period of high interest rates, could not conceivably afford the carrying costs of such inventories. Japanese machine tool manufacturers somehow or other were able to maintain those inventories.

This goes back to a whole array of advantages, some of which have been identified here today. No. 1, the fact is that interest rates have always been so much lower in Japan to begin with. And on top of that, they get tax advantages and subsidies to facilitate their transfer of these products overseas.

All in all it gives them an extraordinary advantage which they tend to describe in terms of, well, gee whiz, we are just better marketing people because we maintain inventories. Well, that is not better marketing, that is just a deeper pocket, someone who is prepared to absorb the costs of maintaining those inventories when an American manufacturer cannot do that.

Chairman **Gibbons**. Our interest rates are too high, our taxes are too high. Is that it?

Mr. **Latona**. Well, that is certainly another way of looking at it. Our taxes are too high right now. That is not of terribly great concern, because profits are so small that the taxes do not particularly impinge upon us. In better times, yes, those taxes of course do absorb funds that might otherwise be directed toward additional research and capacity expansion.

The interest rates are certainly too high. I am not an expert on that subject, but it seems to me that they are well in excess of historical rates above the inflation rate. I do not think we are here to get into that. But it certainly is an advantage to Japanese manufacturers that they are able to pay what seems to be an artificially low rate of interest. They are able to work together so that costs for research into manufacturing techniques can be shared. They have in some cases formal, in other cases informal, exemption from their own antitrust laws, laws which are enforced with extreme rigor here in the United States.

I have a speech here that was given by the Assistant Chief, Foreign Commerce Section, Antitrust Division of the Department of Justice, a speech given in September 1982—I understand the gentleman is no longer with the Justice Department but it is on Justice Department letterhead—warning American businesses that seeking redress under the trade laws, the existing trade laws of the United States can subject them to serious scrutiny by the Antitrust Division of the Justice Department, notwithstanding the constitutional right to petition the Government.

Chairman Gibbons. Did what?

Mr. Latona. It points out—the title is "Antitrust Problems in Initiation and Settlement of Import Relief Cases." It goes on to explain that anybody who is seeking relief under the trade laws of the United States is toying with a violation of the antitrust laws.

Chairman Gibbons. Would you mind putting that in our record at this point?

Mr. Latona. Not at all.

Chairman Gibbons. Good. Well, let us put it in.

[The information follows:]

REMARKS BY CARL A. CIRA, JR., ASSISTANT CHIEF, FOREIGN COMMERCE SECTION, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE, ENTITLED "KEEPING THE JINNI IN THE BOTTLE—ANTITRUST PROBLEMS IN INITIATION AND SETTLEMENT OF IMPORT RELIEF CASES"

The relationship of competition policy to the policies expressed by Congress in the set of laws which American manufacturers may invoke to gain protection against increased penetration or low prices of imported goods depends on where you stand. If you're a United States business executive struggling to preserve market share in the face of an onslaught of low priced foreign goods, you probably don't waste much thought over whether the pricing policies of your foreign adversaries are benefitting U.S. consumers. On the other hand, if you are a consumer you probably appreciate the added range of choice represented by those competitive foreign products, and would be dismayed if pressures from other sellers ended up causing less of the products to be available or their prices to rise.

Like most recent national administrations, the present one has tried to maintain international trade policies that attempt to meet the challenges of foreign competition without major deviations from free market principles. As the primary Federal agency charged with preservation of competitive markets, the Justice Department views the trade laws and the remedies available under them as we regard any other regulatory deviation from the basic competitive market mechanism which our nation has adopted as the fundamental determinant of its economic life. Certainly, import relief laws are to be respected as expressions of national will on the rules by which foreign competitors must play if they wish continued access to our markets. But as their successful invocation will often produce anticompetitive results in our domestic markets, we continue to think it important that their enforcement be informed, where possible, by competitive considerations. While the past Chairman of the International Trade Commission has acknowledged the relevance of competition policy considerations in the shaping of remedies by the ITC,[1] its determinations rarely reflect notable reliance on the need for preservation of essential foreign competition in United States domestic markets.

Nevertheless, in our role as competition advocates in regulatory agency proceedings, and within the interagency councils of the Executive Branch, we have pressed on, and we have often had important impact on the final outcome of these matters. In the Trade Policy Staff Committee which advises the President on whether to accept remedial actions recommended by the ITC, we have sometimes opposed extensions of relief from import competition in circumstances where, for example, domestic markets are concentrated or where margins of underselling might reflect peculiarities of home market price structures not controllable by the importer, or where there seems to be little prospect that the domestic industry can or will effectively adjust to meet the import competition. Of course, it has been noted before that the remedies available under the import relief laws for dumping[2] and subsidies,[3] and especially the escape clause[4] remedy, are to some extent at odds with the

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Footnotes not supplied.

procompetitive national policy reflected in the antitrust laws.[5] And I have introduced my topic in this way, not as a prelude to another re-hash of the philosophical arguments on both sides, but to give you a clear impression of our orientation.

Now, putting aside the policy portfolio, and assuming the validity or at least the neutrality of the statutes involved, I would like to point you toward some antitrust danger areas which counselors of companies and trade associations should be alert for when actually involved in or contemplating trade law actions.

To begin with, resort to the trade laws almost always involves joint action by competitors, since the test for injury under these laws is based on harm to an industry as a whole. The Sherman Act, of course, prohibits competitors from joint action which is designed to restrain trade or to monopolize certain product or geographic markets. A Supreme Court-created exception to this general antitrust check on joint action for anticompetitive ends protects the right to band together to seek government action which will have the inevitable effect of curtailing competition from one's rivals in a market. That exception is of course embodied in the well-known *Noerr*[6] doctrine—a general reference to a line of cases which basically hold that joint efforts to procure various kinds of government action—administrative, quasi-judicial, judicial or legislative—having the necessary effect of imparing the operations of competitors would not violate the antitrust laws. In later expanding upon this rule, the Supreme Court also recognized an exception, the so-called "sham" exception to the *Noerr* doctrine, which remains somewhat ill-defined in the cases.

The sham exception, first articulated in the 1972 *California Motor Transport*[7] case, would seem to apply most clearly to a situation where litigation is initiated in bad faith with the sole intent of harming a competitor. *California Motor Transport* and subsequent cases make clear that use of actual or threatened administrative or judicial proceedings to chill competition can be actionable in antitrust. Although that case involved a pattern of repeated resort by a group of existing trucking companies to administrative agencies and courts to oppose license applications as part of a larger plan to prevent the growth of competition in trucking services in California, in recent times several lower federal courts have interpreted the precedents of *Noerr* and *California Motor Transport* as permitting sham exception antitrust liability in the case of a single meritless claim.

In *Colorado Petroleum Marketers Association* v. *Southland Company*[8] the United States district court for the District of Colorado held in 1979 that a single knowingly baseless filing by a group of gasoline retailers charging another retailer with predatory pricing was sufficient to survive a motion to dismiss. And in the same year the United States district court for the District of Delaware sent a shudder through the trade law bar when it decided that a single groundless antidumping petition submitted to the administering authority stated an antitrust claim. In the latter case, *Outboard Marine* v. *Pezetel,*[9] the antitrust claim was asserted as a counterclaim by the foreign party proceeded against for dumping. Both cases relied on the Supreme Court's opinion in *Vendo Co.* v. *Lektro-Vend Corp.*[10] which upheld a similiar finding by the Northern District of Illinois. Again, however, let's remember that we are speaking of plainly unfounded claims, not merely inadvertent or unsuccessful ones.

In recent years, the Justice Department has also investigated a matter based on another variation of the knowingly false antidumping claim. The situation involved a United States trade association in an industry whose members felt increasing pressure from imports from a particular country. Over a period of nearly a year, the association executives and member of the industry appeared to be conducting a campaign against the imports in the media, including interviews and articles in trade press and public addresses at association gathering, asserting that the imports were being dumped and that unless this activity stopped, the American group was prepared to file an antidumping case.

The matter came to our attention after the foreign sellers all had raised their United State prices in apparent response to the United States industry's complaints. The action of the foreign producers was taken with a similar amount of public press exposure. Our investigation was conducted not merely as an inquiry into the pricing actions of the foreign producers, but also on the basis of of possible conspiracy among the foreign and the American producers to raise the price of foreign goods sold in the United States. In our investigations we sought documents showing the basis for the U.S. producers' assertions of dumped sales (which had been denied by the foreign producers.) One factor pertinent to the *Noerr* inquiry was the length of time which passed between assertions that the American producers were about to file a dumping case and their ultimate failure to do so. In addition, while they had engaged outside consultants to assess the prospects of success, the reports had apparently not been encouraging. We also attempted to ascertain whether the association or any of its members had performed or commissioned economic or market studies in preparation for actual filing of a dumping complaint. For various reasons, we ultimately decided not to proceed with a case, but we are watching this general kind of behavior carefully.[11]

What if there is no doubt about the good faith belief of the potential petitioners in the accuracy and proof of their potential dumping case, yet they still would like to avoid the expense and inconvenience of pursuit of the available administrative remedy? The resemblence of the situation to that which prompts an ordinary prefiling settlement discussion in many other law suits may tempt potential petitioners to seek a resolution with the potential respondents. This is an extremely perilous idea from an antitrust standpoint. When companies threaten an antidumping suit and instead of filing, use that threat directly or indirectly to obtain a lessening of foreign competition, they place themselves in serious antitrust jeopardy simply because the nature of the dumping charge is significantly different from the charge in most other legal contexts. Since the gravamen of the complaint has to do exclusively with the level of the price charged by one's competitors, contact with the other side is not quite as neutral as the usual notification of a potential legal opponent of your intention to file suit and invitation to discuss settlement terms in advance. Because dumping grievances presumably can be settled only by undertakings regarding prices, output, or both, and since collusive pricing of products in a competitive market is at the very heart of the concern of antitrust law, private managements between domestic producers and foreign importers in settlement of an actual or potential trade complaint can raise very serious antitrust questions. The Supreme Court has demonstrated its agreement with this view in the domestic context in the *Gypsum* [12] case where, in defense to a Sherman Act price fixing charge, it bad been asserted that it was necessary to discuss and verify competitor's price levels with them in order to avoid violating the domestic laws against price discrimination.

Now I would like to discuss the difficulties under antitrust law that may arise in the context of a filed dumping or countervailing duty case in which an attempt at settlement may be made during the course of the proceeding. This is a rather tricky area, but Congress did make major improvement in the Trade Agreements Act of 1979 by providing specific authority for acceptance of settlements by the authority administering the antidumping and countervailing duty statues. Thus, in line with general public policy favoring settlements of litigation, the Commerce Department has been given authority to suspend or terminate antidumping or countervailing duty proceedings upon its acceptance of an agreement with the foreign respondent to cease exports or eliminate the dumping margins by price undertakings. Congress intended in providing this authority "to promote rapid and pragmatic resolutions."[13] The Senate report noted that it was not intended that settlement become the preferred means of case disposition, but should only be employed where the public interest and the interests of the domestic industry would be served. The domestic industry must be consulted by Commerce in deciding whether to accept a settlement offer. However, it is important to note that formal termination or suspension of an investigation is authorized by the law only after the affirmative preliminary determination of dumping or subsidy has been made by the Commerce Department.

Commerce regulations provide for publication in the Federal Register of its acceptances of settlements, and their terms,[14] but "unilateral" withdrawals of complaints do not occasion the same obligation. Unfortunately, there may be strong incentives during the period prior to the issuance of the preliminary determination in which parties doubtful of their chances for full vindication in the proceedings may send signals to their opponents as to the level of price or volume which would induce a withdrawal of the complaint.

For the respondent the incentive is usually the avoidance of administrative findings of high margins of underselling, even if only preliminary. For the petitioner, besides the foreshortening of expensive litigation, the incentive is the elimination of the possibility that the injury phase of the proceedings may not turn out favorably. There have been many instances of findings of less-than-fair-value sales or of subsidies during the first phase which have been mooted by a failure of the International Trade Commission to find injury. Even when injury is found, the administering authority has some discretion in actually imposing compensatory duties.

I do not here wish to be understood as implying that unilateral withdrawal of petitions for import relief is an automatic cause for antitrust suspicion, but only as pinpointing a particularly dangerous period in the course of the administrative process. It must be recalled that until the preliminary determination there is no specific statutory authority for acceptance of a settlement by the administering authority; so that, in beginning and concluding *de facto* settlements before that time, there is substantially more danger that the events could be interpreted later as government officials acting merely as a conduit for the parties to achieve a direct price agreement.

Arriving at last upon the safest ground, settlements occurring after a preliminary determination, there still is some danger remaining. It is evident that even though a clear public interest standard has been imposed by Congress, the administrative agency would have to have some reaction to a respondent's settlement offer on the part of the petitioners. Thus Congress provided for input by petitioners into the process, and it is standard practice for Commerce to discuss the proposed undertakings with the petitioners. But the new law contemplates that the Commerce Department will use its own expertise and discretion and a large measure of independent judgment in deciding that the public interest justifies acceptance over the objections of petitioners, and not merely act as a conduit for price settlements between respondents and domestic concerns. This is implicit, I believe, because under the Trade Agreements Act of 1979 Congress has provided a right of judicial appeal for petitioners to challenge settlements accepted over their objection. [15]

Finally, in speaking of settlements of trade law disputes, I would be ducking the biggest story were I not to mention the continuing saga of the European-American steel trade dispute. We have seen over the past three years a series of extraordinary events, all revolving around the invocation of the trade laws—the giving and the taking away of the trigger price mechanism; the threatening and the filing of antidumping and countervailing duty cases; and attempts, at an intergovernmental level, to negotiate export restraint agreements. The negotiated restraints would forestall the ultimate imposition of substantial compensatory duties that may be required by the size of some of the margins of subsidization found by Commerce. Antitrust counsel have been active both within the governments and within the involved and affected companies on both sides of the ocean.

As we have seen, in the recent past in the context of the Japanese auto question, when a trade dispute between private parties is sufficiently important in terms of international trade, enormous pressures quickly arise for resolution of the dispute on a political level or at least in arenas apart from the confines of the administrative procedures under the trade laws. Of course, these times are the most worrisome for antitrust counseling. They are normally characterized by confusion and contradictory reports in the press as well as within the warring foreign and domestic industries.

We have provided antitrust advice to the agencies of our government actively involved in various phases of the steel dealings, and will continue to do so. Our duty in this situation is not to promote the Antitrust Division's policy preferences in such matters, but to provide straight legal advice, once our client has decided to attempt a negotiated settlement. While detailed treatment of the antitrust implications of the negotiation of import limitation agreements with foreign governments is beyond the scope of today's presentation, I have brought it into this presentation to illustrate that the decision by American industry to invoke the import relief laws may really amount to a decision to call forth the jinni from the bottle. Unlike the decision to file a private lawsuit, it is an uncontrollable process. It carries with it a host of uncertainties as to the ultimate outcome, and the need for antitrust counseling is present at virtually every stage.

Mr. LATONA. It refers to the so-called Noerr-Pennington doctrine, which is a legal exemption to allow people to petition the Government for relief without violating the antitrust laws. It then goes on to describe the so-called "sham" exceptions to the Noerr-Pennington doctrine and places great emphasis on that. It can only be read, and indeed I have had legal advice that says that anybody following the path of asking for relief, particularly through trade associations but not necessarily just through trade associations, ought to be very, very careful.

Now, on the other hand, we have the Japanese Government telling its businesses, you are exempt from the antitrust laws.

Chairman GIBBONS. We are going to have hearings on this subject next week, and I am glad you are bringing it up now because I did not know that we were going around and threatening people to not take advantage of the laws we passed. What triggered the Justice Department to write such a letter? Who was it directed to?

Mr. LATONA. It was a speech given at a World Trade Institute seminar in New York City.

Chairman GIBBONS. Was that a change in Government policy?

Mr. LATONA. No, sir.

Chairman GIBBONS. Or did the fellow have to give a speech and did not know what else to say?

Mr. LATONA. Oh, no, there is a particular incident referred to in the speech that goes back to the previous administration.

Chairman GIBBONS. Well, I am sorry to hear that. I am glad you brought it to my attention.

Mr. LATONA. Well, it is a very, very small example, but it is a dramatic contrast with the policies of the Japanese Government certainly. And it again shows the burdens under which we operate.

On the other hand, the Japanese are getting their cartel not only officially created and sanctioned but bankrolled as well.

Chairman GIBBONS. Why did Houdaille pick the particular form of remedy that it did?

Mr. LATONA. Well, our chief executive officer has for many years thought that the investment tax credit should go only for U.S.-value added. And a couple of years ago now we were contemplating perhaps trying to suggest that some legislation along those lines be adopted.

In the course of those discussions and in speaking with Jim Mack at the Machine Tool Builders Association, he brought to our attention that there was already discretionary authority for that under section 103 of the Revenue Act of 1971. We were quite surprised to learn that, and as it turned out when we started wending our way through the process, there are an awful lot of other people both in Government and in the private sector, trade law experts in Washington and elsewhere who were quite surprised to find that this was on the books.

Chairman GIBBONS. In your research did you find out where and how that got on the books?

Mr. LATONA. Yes.

Chairman GIBBONS. Where? I am interested to know.

Mr. LATONA. When President Nixon put a 10-percent surcharge on imports back in 1971, it was also the time that the investment credit was being reintroduced. Someone pointed out that it did not seem to make too much sense to have an investment credit for imported goods when we were putting a 10-percent surcharge on foreign goods.

So in the reinstitution of the credit there were two additional sections to the law: The first said that there would be no investment credit for foreign goods without approval of the President as long as the emergency decree was in effect.

Then there was a second part, which is what everybody forgot, which said that after the decree was suspended, that if evidence could be produced that showed foreign governments were, among other things, tolerating cartels and otherwise unfairly burdening U.S. commerce, the President had the discretionary authority to deny the investment credit.

The bill was passed within a matter of days, I believe, of the suspension of the emergency decree. So for all intents and purposes, the first portion of the section did not come into play, and the second section has been on the books since 1971.

Chairman **Gibbons**. I am interested because I do not remember that having been in the bill.

Mr. **Latona**. It was put in in conference.

Chairman **Gibbons**. It must have been put in in the Senate then. I am sure the conferees would have never slipped anything in that was not either adopted in the House or the Senate.

Mr. **Copaken**. There was a similar provision passed by the Senate and then with a few changes it was adopted in conference in this present form.

Mr. **Latona**. There was considerable discussion of the issue, however. Among other things, as I recall, the bill was actually labeled the Jobs Creation Act or Job Development Act of 1971. Obviously——

Chairman **Gibbons**. I remember that. I was sitting right over there, right over here somewhere, when we were doing it. But I just do not remember. That was something we never took up in the House.

Mr. **Latona**. As I say, virtually no one that we encountered when we started this was aware that the law was on the books. We also felt that we would have some advantage. We were not just following a whim.

We also felt, No. 1, that the remedy was a particularly effective one and the administrative features of it particularly flexible, that since it had not been used, it might be easier to persuade the President to use it and we might be able to get a faster hearing.

I am told that we have proceeded with great rapidity. We started in September 1981. We filed in May 1982. Here it is March 1983, and we may—repeat—may be on the verge of some kind of result.

So we felt that the remedy and the administrative procedures for it were particularly attractive and that perhaps the novelty might give us some attention that separated us a little bit from the rest of the crowd.

Frankly, the track record of the other remedies available is not such that would give people a feeling that going the same old route was going to be productive.

Chairman **Gibbons**. As I recall, what happens is that the President can retroactively repeal the investment credit for those companies that took advantage of it, having bought the Japanese product. Is that right? Is that the way it works?

Mr. **Latona**. I doubt that it would be retroactive.

Mr. **Copaken**. I think it would be retrospective.

Chairman **Gibbons**. But the way the statute is written, it can be retroactive, can it not? I am not familiar with the statute at all, that is the problem.

Mr. **Copaken**. I do not believe that it is subject to that reading. I do not think so. I think it is a prospective action, but I think it is broad enough to contemplate redress of historical actions that have had effects that continue to the present time.

Mr. **Latona**. That would not be imposed on people who have already made purchases.

Chairman **Gibbons**. Well, that is an interesting piece of history. Someday I will find out who put that one in there. It will take a little while. I am not really surprised. That happens quite often, particularly in those days back when we had very close cooperation in both the Ways and Means Committee and the Senate Finance Committee in the Conference. Quite often people did not know what was in the legislation.

Mr. COPAKEN. It is a very short provision in the statute, so you might just have it before you. It says: If on or after the date of the termination of Proclamation 4074—which was December 19, 1971—the President determines that a foreign country, one, maintains nontariff trade restrictions, including variableimport fees which substantially burden the U.S. Commerce in a manner inconsistent with provisions of trade agreements; or, two, engages in discriminatory or other acts, including tolerance of international cartels or policies unjustifiably restricting U.S. commerce, he may provide by executive order for the application of subparagraph (a)—which is the paragraph that excludes foreign-produced property from qualifying for the investment tax credit—to any article or class of articles manufactured or produced in such foreign countries for such period as may be provided by executive order.

Chairman GIBBONS. You would not interpret that to be retroactive?

Mr. COPAKEN. I guess the language conceivably could take that meaning. I just think it is unlikely that the President would apply it retroactively to a company that purchased in good faith as distinguished from setting a clear warning as of a date certain that anyone who purchases after this date will do so with the knowledge that the foreign good would not be entitled to the investment tax credit.

Chairman GIBBONS. All right. Well, thank you very much.

Mr. Pease?

Mr. PEASE. Mr. Chairman, I will be brief.

I am interested in some elaboration of the list you gave us before of the unfair practices that the Japanese have with regard to your industry. You mentioned protection of the home market. Was there a home market at one point that we had any penetration of, and did our penetration end or drop off at some point when the Japanese decided to protect that market?

Mr. LATONA. It was nowhere near as dramatic as the chart that was shown by a previous witness for the semiconductor industry. The Japanese have manufactured nonnumerically controlled tools, simpler machine tools, if you will, starting before World War II. When the United States developed numerical controlled technology, the Japanese immediately recognized its utility, and at that stage decided that they were going to target that high technology end of the machine tool industry, and at that point, very aggressively sought out U.S. licensing arrangements and U.S. technology.

So, there had been no real market yet developed in Japan for numerically controlled machining centers, and none really ever did develop for U.S. manufacturers. They began to develop their own manufacturers, and the Japanese industry was ordered to go into some 50 percent of its domestic production for numerically controlled machines. This is a hothouse effect to create a strong market for the product.

United States machines were purchased in small amounts essentially for reverse engineering and research purposes.

Mr. **Pease**. That order came from whom?

Mr. **Latona**. The Japanese Government.

Mr. **Copaken**. There was, in addition to the points that Mr. Latona raised, there was a specific approval system for imports into Japan of machines such as these machine tools. One study that we found of this import approval system stated that in order to protect its domestic industries, the Government of Japan adopted a standard under which applications for approval to import machines into Japan were to be rejected if Japanese-made machines of the same kind and of equal efficiency were available, or if other Japanese-made machines of a different kind which could be used for the same purpose were available.

So, essentially, and the citation there is Kamura, various issues concerning the post-World War II economy—the citation is at page 48 of the petition. Essentially, it was a standard that allowed in only those machines that could not be replicated domestically in Japan. It is a total ban.

Mr. **Pease**. OK. That is helpful.

Let me turn to your point about the financing of inventory in machine tools. You were citing the example of having machine tools on the shelf ready to deliver. Do you have any evidence that the inventory was financed by loans from the Government as opposed to private banks?

Mr. **Latona**. Loans directly from the Government?

Mr. **Pease**. To the machine tool manufacturers.

Mr. **Latona**. Most of the loans are through the banks, but the banks are heavily controlled and directed by the Government in their activities. Beyond that, there are provisions for various forms of relief from the Government, depending on if you qualify as a small business that I am aware of, and a very high percentage manage to qualify as small businesses, and there are various techniques to make sure that you do qualify as a small business.

Mr. **Copaken**. There are also special tax subsidies for maintaining inventories that are part of the Japanese scheme that applied to all of these companies.

Mr. **Latona**. They also have very, very high writeoffs for bad debts, whether the bad debts exist or not.

Mr. **Copaken**. In addition, we learned——

Mr. **Latona**. Depreciation schedules are doubled and trebled.

Mr. **Copaken**. In addition, we learned quite recently that with a number of these machine tools, title is held by the trading companies, and they are able to get their financing in Japan at very favorable terms.

Mr. **Pease**. Are the inventories held in Japan or the United States?

Mr. **Latona**. Primarily in the United States. A certain portion of the production is anticipated to go to the United States. You can hold it either in Japan, or some of it is on the boat at any given time. In the United States, some of it is in bonded warehouses, some in nonbonded warehouses, some held by distributors or trading companies.

In the last year or so, they have been engaging in a practice of selling the product, what we would describe as selling on a contingency basis. A buyer would have the right on a free trial basis to a machine tool, which is quite an unusual practice, to say the least, to give a machine to a user for 3 months, 6 months, sometimes longer, on a no-cost basis, and then if he decided he did not want it, why, he could give it back.

Apart from being quite an aggressive marketing technique, to say the very least, it is another way of placing your inventory out of your shop and writing it up as a sale, even though in fact the buyer has never paid anything, and has the complete right to give the product back after a period of time.

Mr. PEASE. Do you have any evidence at all that the loans for this inventory are made at rates below the normal market rates for Japan?

Mr. LATONA. Below the normal market rates for Japan?

Mr. COPAKEN. We do have records of a number of concessionary loans that were either on concessionary terms or concessionary in terms of the availability at a time when they would not otherwise qualify for credit, but we have not yet been able to tie those directly to the precise point of these inventories. We are still working on it.

Mr. LATONA. For much of this period, U.S. interest rates were in the 18 percent and higher bracket, and the Japanese prime rate was in the 6- and 7-percent range. One did not have to grant anything special for Japan in order to have a dramatic competitive effect in the United States.

Mr. PEASE. Do you have any evidence at all that loans were made which might not be justified on ordinary commercial terms?

Mr. LATONA. I am sorry? In Japan, that would not be justified in commercial terms?

Mr. COPAKEN. There is quite a bit of documentation—I do not know if I can find it quickly, but there is quite a bit of documentation in the petition on that issue. There in fact was one program we discovered that was not administered by MITI, although in close coordination with MITI.

It was administered by the Ministry of Science and Technology, under which industry could get substantial loans to engage in research and development, and if the fruits of the research and development became commercially successful, then and only then were the companies obliged to repay those loans over a 5-year term at no interest.

If the research turned out to not be commercially successful, the entire loans were forgiven.

Mr. LATONA. Then of course, there is our famous bicycle race money.

Mr. PEASE. There is what?

Mr. LATONA. Our famous bicycle racing money. The fact that the Japanese machinery industry, which is a larger category than just the machine tool industry, but the machinery industry gets in the neighborhood of $800 million to $900 million a year from the proceeds of betting on bicycle and motorcycle races. The Japanese Government first told us that was only $500,000 or some tiny amount of money, and then they finally now admit to $100 million.

We have the actual documents that demonstrate that, I think, in 1980 it was some $800 million; in 1981 it went up to over $900 million.

Mr. **Copaken**. The precise figure is that in Japan's fiscal 1979 year, there was 185 billion yen, or $918.9 million. In the following year, it went up in yen to 189 billion yen, which is equal because of the differing dollar exchange rate to 823 million.

So, it has been running at a clip of close to $1 billion a year made available in a rather complex scheme to the machinery industry for the development of machinery and promotion of export of Japanese machinery.

Mr. **Pease**. This is money made available to private corporations?

Mr. **Latona**. Yes, sir.

Mr. **Copaken**. Yes, and through various methods. Among other things, we have obtained a list of every single recipient of individual grants out of this fund, the amount of these grants and a general description of the grants, and I have had an opportunity to visit a couple of the recipients of these grants and to videotape the fruits of these bicycle funds.

One such facility is the facility known as the Technical Research Institute, which is a part of the group called the Society for the Promotion of Machine Industry. It is located outside of Tokyo. I videotaped a tour of that facility, where they showed a number of machining centers that were developed with these bicycle funds, including one—I noticed you had some questions earlier in the day about the aircraft industry, for use by the aircraft industry.

One of the machine centers that I saw at this particular facility—we also obtained a booklet describing the development of that first Japanese five-axis machining center with government funds, and it notes in the paper that describes it that it is essentially a precursor to their targeting the aircraft industry. That might be of some interest.

Mr. **Pease**. OK. You mentioned earlier accelerated depreciation schedules or faster writeoffs for bad debts.

Mr. **Latona**. Yes.

Mr. **Pease**. Do you have any evidence that that is differentiated by industry? In other words, by those which are targeted versus those which are not targeted?

Mr. **Copaken**. It is in a rather clever way. That is, for example, there is one that is currently available that allows any manufacturing facility that operates 24 hours a day to take 56 percent additional depreciation in the first year on top of the normal depreciation, and of course that is clearly geared toward the robotic industry, which is another form of machine tools.

They had these factories of machining centers that are manufacturing other machining centers with very little human involvement. And they are capable of operating 24 hours a day.

We were able to ascertain that one of these facilities by Yamazaki in Nagoya does take advantage currently of that 56 percent additional depreciation the first year.

Mr. **Latona**. You can take advantage of this with certain types of items that you are manufacturing even without robotics, if you have a sufficiently high volume of products to run these machines 24 hours a day.

Mr. **Pease**. Is it your feeling that firms in a targeted industry have greater access, putting the interest rate aside, greater access to loans than firms in nontargeted industries?

Mr. **Copaken**. Absolutely. One of the important factors about the Japan Development Bank loans that are made specifically to the targeted industries is that they in turn signal the entire commercial banking community that the government has decided to put its resources into this particular industry, and they in turn lead to a greater ease of getting commercial financing that would not otherwise be available.

So, their value is really out of proportion to the concession on the interest rate itself.

Mr. **Pease**. I think that is an important point, Mr. Chairman. If a bank in the United States is thinking about whether to loan money to a company, it has to decide whether that company has a future, and whether the industry has a future. If the Government somehow has annointed that industry, the bank automatically assumes greater security in making the loans to that company within that industry.

Even if the interest rate does not change, that could be a factor. The traditional lament of the small businessmen in my area, particularly in new technologies, is that the banks would be glad to loan you the money if you do not need it. If you do need it, you cannot get the financing.

Well, I think this has been very helpful testimony. I am interested very much in differentiating advantages that are available because of these targeted industries from the natural advantages. I think if the interest rate in Japan is 7 percent or 8 percent versus our 18 percent at a given time, those are factors that do not relate necessarily to targeting.

We cannot really complain about that. We had at one point cheaper natural gas rates, for example, but I think you have been successful, at least in my eyes, in identifying some advantages which are peculiar to those industries which get targeted.

Mr. **Latona**. Again, they all fold into a pattern which it is impossible for even us to see all of, because we only know what we have seen. We do not know what we have not seen. But when your competitors are ordered out of the business by the Government, again, this is not only a great advantage in and of itself when you are given a piece of their market, but again, that is a signal given to many, many other people that this is one of the annointed and they ought to cooperate.

And, of course, the Japanese social system is much more cohesive. The leaders of business and the leaders of government, and indeed even the leaders of the unions, all come essentially from the same educational background, in many cases the same institutions, and work back and forth with one another far more closely than here in the United States.

I saw a statistic the other day that some substantial portion of the chief executive officers of Japanese industries at one time or another had been president of the company union. To say the least, that is not the practice here. And be that as it may, this is a natural phenomenon there, and something that we cannot and are not complaining about, but it shows the degree of integration of that society, and how things can be brought about on an informal and perhaps even unstated basis, simply because everybody agrees, and that is the way it is going to be, and everybody knows it.

So, there are not necessarily, you know, written documents setting forth exactly how it occurs.

Mr. COPAKEN. There is another good specific example of what you are asking for. That is something that is given specifically to the targeted industries that is not normally available in Japan. That is this specific de facto immunity from their antimonopoly law. Their antimonopoly law is patterned after our own antitrust laws, and presumptively has general application throughout the Japanese society.

But under a series of extraordinary measures, laws that were first enacted with regard to this industry in 1956 as a temporary measure, but are still in effect today and will be renewed presumably again next year, there is specific authority for MITI to issue instructions to the industry, the targeted industry, to take concerted anticompetitive action, and if they give these instructions, there is specific statutory immunity from their antimonopoly law.

However, under the statutory approach there are some mild restraints on the degree of how anticompetitive the conduct can be, and the method that they have used instead is an even more pernicious one. Instead of issuing such instructions, what they do is, they publish general notifications to the industry to take specific anticompetitive actions.

The industry then responds voluntarily with a cartel, formal cartel agreement, and by a gentleman's agreement, so long as that cartel agreement precisely follows word for word the general suggestion of MITI, it is understood that there will be no investigation by the Fair Trade Commission, no enforcement of the antimonopoly law, and no limitation on the degree of how anticompetitive the conduct can be.

We have confirmed that in a direct meeting with the Japan Fair Trade Commission, where we presented them with a copy of a cartel agreement, asked them to read it in Japanese, and then asked them what they thought of it. They more or less conceded that it was a clear violation of their antimonopoly law, but told us that there was no intention to do anything about it whatsoever.

Mr. LATONA. Again, the whole attitude is quite different. Just in going through out research in Japan and interpreting and translating documents, the word "anticompetitive" has in fact a totally different meaning. To us, anticompetitive behavior is a group of business people getting together in a room some place and cutting up the market, or setting prices, or that kind of thing.

In Japan, it tends to refer to the people who do not go along. The guy who is anticompetitive is the guy who is not participating with the rest of the group.

Mr. COPAKEN. They have a concept of excessive competition, which is considered a problem there. It refers to those who do not cooperate with the group. It is rare.

Mr. PEASE. I will yield back my time in a second.

Your comments remind me of those constituents of mine who are convinced that the Trilateral Commission is a great conspiracy and that somehow these bankers and Eastern Establishment Princeton graduates and Harvard graduates get together and make all sorts of decisions affecting our economy. It is almost as if the U.S. Commerce Department would decide secretly they were going to favor this industry or that industry, and then pass the word along to the Trilateral Commission, who would in turn pass it along to every bank on the east coast.

Mr. LATONA. I think it looks that way when it is described by Americans to other Americans. We cannot conceptualize this kind of activity in any other fashion. Based on what I have read about Japan, and I also now read the Japan Economic Journal regularly, and while I do not pretend to be anything remotely resembling an expert, one can see it is completely a part of the way they do things, and so therefore it does not have quite the same sinister overtones that it has when we discuss it.

I think Mr. Tanaka's testimony and indeed the submission of the Japanese Government in response to our petition, which was, essentially, "this is the way it has always been done, and this is the way we do it, this is simply how it is, it is not anything out of the ordinary, it is not anything malicious, it just is."

Most people describe their ways of doing business in essentially that fashion.

Mr. PEASE. Well, I think that it is an important point. It is part of the Japanese system. They do not view it as necessarily evil. It is highly unlikely that they will change. It is highly unlikely, given our traditions, that we will emulate it. And it seems to me highly unlikely that we, with our traditions, can compete against the advantages of that system.

I do not know where that brings me out, unless it is to Lester Thurow's idea to say that the end result is what the gap is between our exports and their exports. Maybe that is the proof of the pudding.

Thank you very much.

Chairman GIBBONS. Let me ask you, how did this bicycle racing fund get over into machine tools? That intrigues me.

Mr. LATONA. There is a very, very elaborate process. As I said——

Chairman GIBBONS. When did it start, and how did it come about?

Mr. LATONA. It goes back even further to the sugar quota. Historically, the first targeted industry was the shipbuilding industry. Very early on in, I guess, the late forties, when the Japanese Government wanted to assist Japanese shipbuilders, they also wanted to restrain consumption of sugar, or at least capture the economic benefits of the constraint on the consumption of sugar.

They put limitations on the amount of sugar that could be imported, and then the right to import sugar became extremely valuable. Rather than just to give it off on a political basis or a favoritism basis, they allocated it to the industries that they were attempting to assist in the first instance, to the shipbuilding industry. There is a very elaborate procedure by which the more you exported your product, the more sugar you could import. This boon was eventually granted in part to the machine tool industry, the more you exported, the more sugar you were able to import.

Then people found out about that, and there were a lot of objections from foreign governments, and so that was stopped. I think also there was a banana importing arrangement. However, they then switched—

Chairman GIBBONS. I knew they did it in oranges.

Mr. LATONA. I do not know how much money is derived for subsidies out of orange importation.

Chairman GIBBONS. It usually goes to the political party.

Mr. LATONA. You are the expert on oranges.

Chairman GIBBONS. Not me. It is the "Wall Street Journal." I am just repeating what I read in the "Wall Street Journal." It has never been denied that I know of by anybody.

Mr. COPAKEN. In the very year that they stopped the sugar subsidy, they shifted over and tapped into the bicycle race fund, which had been going on for a couple of years. The bicycle races began with a law that was passed in 1949 and for the first several years the betting funds were used to finance the bicycle industry.

But in the year in which they stopped the sugar subsidy for machinery, they had to find a new way to subsidize it and they decided to tap into the bicycle funds, and in that very year half of those funds, more than half, went to the machinery industry, less than half to bicycles. Every year thereafter the proportion that went to machinery began to increase, to the point where it is now about 85 percent for machinery and 15 percent for bicycles.

Chairman GIBBONS. They did that in the statute?

Mr. COPAKEN. Yes.

It is called the bicycle racing law. A copy of the law is also contained in the petition, and under that law it is an interesting scheme. Certain designated municipalities in every prefecture are allowed to operate these races and the parimutuel betting on the races. Under the statute they are obliged to give three-quarters of the bets back to the holders of winning tickets and one-quarter they keep, less the expenses and less a statutorily defined contribution to a national bicycle association.

The national association then aggregates about $100 million a year from those collections, which it then expends on the machinery industry as per MITI's direction. The lion's share, about $800 million, stays with the municipalities and prefectures.

It goes into their general revenues, and then out of their general revenues comes funds to support regional technology centers that promote the machinery industry.

Mr. LATONA. Again at the direction of MITI.

Chairman GIBBONS. You know, I guess that is where we got the idea in Florida that we could do that for football teams through the parimutuel betting.

Mr. COPAKEN. They bet about $5.5 billion a year on bicycles and motorcycles.

Chairman GIBBONS. We had a similar situation at one time in Florida where, you know, the parimutuel betting was all controlled by the State and they were always anxious to curry the favor of the State legislature. They would do anything from buy you to wine you and dine you or anything else they could think of to keep you happy.

So some of the football teams were having a hard time recruiting players and paying scholarships. They set up charity days at the parimutuel racing, all at the direction of the State, of course, and kicked the funds back to the schools to help deserving students, all of which for a week were football players. It did not do very good for the football team.

I wondered where we got that idea. I guess it is just an old Japanese custom. We have abandoned that, though.

Mr. **Copaken**. They have not.

Mr. **Latona**. Maybe the Gators would have gotten Herschel Walker had they not.

Chairman **Gibbons**. It was not the Gators. I will defend them. They always had plenty of money. That is not the Gator problem. It is for some of the other smaller—small colleges that were having that trouble.

Well, nothing new under the Sun. Some things are just more startling than others.

Well, we have got to find some way out of this dilemma. Most things that are done under color of law, those kickbacks and subsidies, to me are the kinds of things that countervailing duty statutes were designed to prevent. Just because it is circuitous does not mean that it is legal.

It is all done by statute under the color of law. It is a tax. It is a tax that is rebated for a specific industry. If you are not successful with this one I wish you would file a countervailing duty on it.

Mr. **Latona**. We cannot afford it.

Chairman **Gibbons**. You got all the legal work done. I am sure that Covington & Burling would be glad to do this.

Mr. **Latona**. We may become a pro bono client.

Chairman **Gibbons**. Thank you very much.

Mr. **Latona**. We appreciate your giving us the opportunity.

Chairman **Gibbons**. We now have a panel of witnesses from the Electronic Industries Association, Telecommunications Group: Mr. John Sodolski, who is vice president of the Telecommunications Group; from the Communications Workers of America, Mr. John Morgan, an old friend and acquaintance of mine, who is executive vice president for legislation and government agencies.

Come forward, gentlemen, and take your places, and you may proceed as you wish.

STATEMENT OF JOHN SODOLSKI, VICE PRESIDENT, ELECTRONIC INDUSTRIES ASSOCIATION, TELECOMMUNICATIONS GROUP

Mr. **Sodolski**. Mr. Chairman, I am John Sodolski, vice president of the Electronic Industries Association and specifically its Telecommunications Group.

I thank you for the opportunity of appearing here today. The subject of my testimony is the NTT agreement. In December 1980 the U.S. Government signed an agreement which promised to open procurements by the Nippon Telegraph and Telephone Public Corp. to suppliers from outside Japan. This was described then as a dramatic change in Japanese telecommunications procurement policy, to be considered a victory for fair and open trade policy in the international marketplace.

In addition, the agreement was seen as a major step in attempting to rectify the trade imbalance the United States has had with Japan. The then Trade Representative, Governor Reubin Askew, and his predecessor Robert Strauss were commended for their leadership and perseverance in their efforts to achieve fairness and reciprocity in international trade.

EIA's Telecommunications Group, at the request of the U.S. Government, had played a unique role in the negotiations over several years. In fact, on several occasions EIA was a direct participant in those negotiations. The conclusion of NTT negotiations can in significant measure be attributed to the active participation of our industry, in close cooperation with our Government.

However, it should be noted that on October 8, 1980, the board of directors of EIA's Telecommunications Group voted unanimously that the only acceptable outcome of the negotiations surrounding NTT procurement matters was complete coverage of NCC by the Government procurement code. That did not happen, and the bilateral agreement currently in force was signed.

We agree with several U.S. Government observers that the real test of the agreements as signed is whether they work. We have monitored closely NTT performance under the conditions of the agreements and continue to urge the U.S. Government to do the same. We understand the U.S. Government has the ability to terminate the bilateral aspects of the agreements if there appears to be a situation wherein NTT is not performing in accordance with the obligations of the agreements.

At this point, more than 26 months after the signing of the agreement, and at least 5 years after the undertaking of the negotiations which led to the agreement, the Nippon Telegraph and Telephone Public Corp. has purchased very little equipment from American sources, and those few purchases have been from the low end of the technology spectrum. We sincerely hope that situation will change soon.

In that regard, it is interesting to note what has happened to telecommunications imports from Japan in the years since signing the NTT agreement. In 1980, exports from Japan of telecommunications equipment to the United States were about $400 million. In 1981 the number was $660 million, and in 1982 we estimate Japanese exports to the United States at $752 million. For the same 3 years, and for the same categories of equipment, U.S. exports to Japan were in the neighborhood of $40 million.

What can be done? At a minimum, the agreement should be simplified. Where U.S. equipment would satisfy Japanese requirements, NTT should consider purchasing that equipment without the complexity of re-doing research and development in conjunction with NTT. In a word, tracks II and III ought to be rethought, reworked, or maybe abandoned.

Further, it would be reassuring if as an addendum to the agreement the Japanese Government and NTT were to stipulate an affirmative action program for the procurement of U.S. telecommunications systems and equipment. An affirmative action goal could be set for each year, that goal being somewhat larger in each successive year.

I might add here that the NTT agreement is up for renewal this year in December 1983.

Chairman GIBBONS. We are aware of that. I trust the Japanese are aware of it.

Mr. SODOLSKI. Indeed they are.

It is a matter of will on both sides. NTT must demonstrate it has taken a definitive position to satisfy some of its more significant requirements for U.S. equipment and systems. U.S. manufacturers, once NTT has convincingly demonstrated its determination to move ahead with procurements from the United States, must pursue that opportunity to the utmost.

Thank you.

Chairman GIBBONS. Let me go back and ask you this. Redoing the research, what is that, on the third page of your statement, next to the last paragraph, third to the last paragraph?

What do you mean by, "NTT should consider purchasing that equipment without the complexity of redoing research and development in conjunction with NTT"?

Mr. SODOLSKI. One of our initial objections to the agreement was its complexity and cumbersomeness. It is in three tracks. Track I is for equipment which is not terribly complicated and can be bought off the shelf. Tracks II and III—track II is for equipment which, while it may exist, must be modified for use in the NTT system. Track III is for equipment which doesn't exist but must be designed for use in the system.

As a practical matter, in order to sell into tracks II and III, which is where the preponderance of the business really is, we must with NTT in a cooperative research and development effort, even though equipment may exist in the United States which satisfies those requirements.

The illustrative thing here is digital switching. There have been working digital switches in the United States for some years, certainly for the last 5 or 6 years. We could have sold those switches into the Japanese network. The Japanese, however, chose not to buy them, but rather to embark on a process where they develop their own among the four or five companies of the NTT family.

It is that point I am getting to. If they chose to purchase the equipment, they could. They instead have chosen to go into the track II and III thing, which involves R&D and protracted reinventing the wheel.

Chairman GIBBONS. Is the NTT family still restricted to five companies there?

Mr. SODOLSKI. I do not know, sir, with any precision whether it is still restricted to those same five. But I hear continuing reports out of Japan that other companies still have not gotten in. But I do not know with precision.

Chairman GIBBONS. Well, obviously we are going to have some results or that agreement is not going to be renewed and the restrictive action that that agreement held off is going to have to be implemented.

Mr. SODOLSKI. Well, it is unfortunate from my point of view that this hearing is this week. Next week our board meets on this matter and I will have much more precise guidance from my members as to what they feel. Right now there are two camps. One says it is not good enough just to stamp our feet and say, we do not like the agreement, it has not worked, and therefore cancel it. The other side says, the agreement has not worked and we have got to do something else. But what is the something else?

Chairman GIBBONS. That is what we are going to be looking at.

Mr. SODOLSKI. I tried to suggest something else.

Chairman GIBBONS. We are going to be looking at all those alternatives a little bit later this year. We just have too full of an agenda right now, but we are going to come back and look at that. It is a serious matter and because—I did not do any of the negotiating, as you know, but I did sit over here and listen to both sides, the Government side and—I mean, the U.S. side and the private industry side of all of these negotiations.

I certainly expected a lot more to come out of it than has come out of it. I have been visited by numerous people from NTT, all of whom have expressed their good intentions. But by this time it should have matured enough so that there would be some real results, and there have not been as far as I am concerned.

Mr. SODOLSKI. Well, we have all had those conversations with NTT officials, in my case for almost 6 years now.

But March 10 is an interesting date. There was a news release, Router, Fin, and Roteman, representing NTT in New York, embargoed until March 7, which announces eight new NTT procurement policies or practices which are effective as of today, March 10, an interesting coincidence.

Chairman GIBBONS. Are they going to help any?

Mr. SODOLSKI. Yes and no. On the face of it, they are a step in the right direction. They will accept American proposals in English, they will accept them through the New York office, they will extend bid deadlines for another 30 days.

However, not the fine print really, but they talk about certain equipment, facsimile equipment, modems, data terminal equipment, especially data terminal equipment such as telephone sets. They do not address the big ticket items where the future of this industry really, really is, and that is switching and transmission equipment. Those are the items which are not covered here and which the Japanese have been especially slow in responding to our efforts.

Chairman GIBBONS. Well, I am sorry to hear the pessimistic report.

Would you like to proceed now? First of all, we welcome you here again, John. We are glad to see you. Go ahead.

STATEMENT OF JOHN MORGAN, ASSISTANT TO EXECUTIVE VICE PRESIDENT—LEGISLATION/GOVERNMENT AGENCIES, COMMUNICATIONS WORKERS OF AMERICA

Mr. MORGAN. Thank you, Mr. Chairman, for asking me. Good afternoon.

Before I start, let me note that in the second paragraph of my very brief statement there is a number of $20 million. The actual should be under $45 million and I am sorry for the error. Quite late yesterday, after a number of months of attempting to secure this hard information from USTR, I did secure it, and that was after this had been printed.

Chairman GIBBONS. That is paragraph two, it should be "well under $40 million"?

Mr. MORGAN. Under $45 million. I believe Mr. Sodolski has used about $40 million.

Chairman GIBBONS. Go right ahead.

Mr. MORGAN. The Communications Workers of America and the Office of the U.S. Trade Representative welcome any and all to the growing group which pronounces the Nippon Telegraph and Telephone procurement agreement a failure. Mr. Chairman, that word failure is not mine. That is a word now being used publicly by officials of USTR in describing this agreement at a public advisers meeting last week.

Our union and the AFL-CIO several years ago urged strengthening of the NTT proposal or its rejection. In late 1980, we got neither. We got instead a very intricate set of procedures which constitute in our view a barrier to open procurement.

We also have received and seen this news release from Ruder, Finn, and Rotman with an effective date of today, which apparently makes matters easier. We suggest a very careful reading of this news release. It also is not official from NTT, or at least an official NTT document to our knowledge, unless Ruder and Finn are now part of that corporation.

To date, NTT appears to have purchased well under $45 million in American telecommunications goods, despite American goods and technology being the world's standard and very competitive. I want to insert here that in the American telecommunications industry since about 1960 there has been a yearly increase in productivity of 5 to 5½ percent kind of on a linear basis.

We are concerned over the NTT matter for several key reasons:

One, that telecommunications is the only growth industry remaining in the economy.

Two, our country must insist that any trading partner execute its side of a bargain, at the risk of severe loss of credibility, and our relationship with Japan is very important. It is the only vibrant democracy out in that part of the world, and our Nation and Japan need to have good relations, trusting relations, mutual respect. We cannot afford to have these exacerbating sentiments flowing back and forth.

Point three: Our industries must be able to enjoy the benefits of that illusive quality sometimes called free trade.

In September 1980 I appeared before this subcommittee and included some rather detailed information on our skepticism over the agreement which was then still in the proposal stage and, despite our efforts and those of a number of others, it went into effect January 1981.

My next testimony on the same subject was in June 1981 before the Telecommunications Subcommittee; by that time, which was almost 6 months into the NTT agreement, NTT had not yet seen fit to issue the standards under which it would exercise procurement.

This, Mr. Chairman, is the book of the standards which became available on or about June 20, 1981. It is interesting to note in this book of standards at the pink dividing page between the first 78 pages in Japanese, and then the rest in English, that the English is a provisional translation. To my knowledge, there is not yet as of today—this document from Ruder and Finn notwithstanding—not yet an official English translation of the standards.

So even though NTT says it is willing to accept applications in English, we still have to note that the person wanting to do an application must study the Japanese version in order to get the official text.

The NTT agreement now is under review for renewal, acording to what we have been told. We are very encouraged by the accounts of Ambassador William Brock's strong pressure on his Japanese counterparts during his recent visit to Japan. We hope that pressure will lead to results instead of more and more promises.

In recent weeks we have been treated to the orchestrated public relations line indicating that the United States cannot afford to terminate the failure represented by the NTT agreement. The reasons frankly make no sense to us, because there is an implication that the United States benefits from an agreement which provides only microscopic commercial opportunity.

To us the true meaning of the agreement is that the United States willingly accepts a commercial disadvantage. We doubt the agreement can be reshaped to become effective. We bear in mind the words of Ambassador Askew's "Dear Saburo" letter, in which friend to friend advice was given, but not heeded.

Thank you, Mr. Chairman.

Chairman GIBBONS. Well, it is a serious proposition and I hope that we can get it straightened out. It is in one sense one of the keystones of our relationship, is this agreement. So much effort was put into it to begin with, and I look forward to getting counsel and guidance from you all as to what can be done about it in the future.

Mr. SODOLSKI. Mr. Chairman, if I may, there is one other aspect to this that I really should have touched in my statement. That is, the deregulation of the U.S. telecommunications market is going to broaden the access to the market well beyond the current terrific access.

Right now we are 40 percent of the world marketplace for telecommunications, the single best organized, most homogeneous, single standard market in the world. It is quite clear why everyone wants to be here, but that will even be easier. Some have said we have unilaterally economically disarmed ourselves in the field of telecommunications, and there is some truth to that.

At a minimum, we must have access to the Japanese market.

Mr. MORGAN. I would agree with that.

Chairman GIBBONS. Do you have access to European markets?

Mr. SODOLSKI. The European markets are, as you know, controlled by PT's and T's who tend to buy from a chosen instrument or several chosen instruments within their own country. The difference between the way the Europeans procure and the way the Japanese procure is where the Europeans, when they need something, they will buy it from the United States. There are many instances of that happening. When their technology lags or we have better delivery, they will in fact buy things. The Japanese simply will not, or at this point have not.

I do not mean to discourage your question. As a practical matter, the European markets are largely closed. In fact, most developed nations' markets, with the exception of ours, are closed.

Chairman GIBBONS. How about in the developing world? Who gets the business in the developing world?

Mr. SODOLSKI. We get some of it, the Japanese get a good bit of it. Several European competitors are very strong: L. M. Erikson, Philips Sanctoven, Siemens, the Brits, the French.

Many European countries are very strong in their excolonies. It is very difficult to get into those markets. We have been quite successful in the Middle East and in Southeast Asia and to some degree in Latin America. The Japanese are there everywhere and are taking more and more business.

Now, this is a vastly complex question because for a variety of reasons, not the least of which is we were competing with only about 30 percent of our productive capacity abroad because until very recently Western Electric and AT&T were unable to go abroad and sell—it was their view the consent degree of 1956 precluded them from doing that. So, we were playing from not a whole deck.

Chairman GIBBONS. But there is no question that they can go abroad and compete now, is that right?

Mr. SODOLSKI. That is correct. They have, in fact, been competing in one form or another since about 1977, 1978 perhaps.

Chairman GIBBONS. Just as an aside, I was in Russia the other day and I picked my telephone up at my hotel in Moscow and turned it over and saw that it was made in Poland. They have a little more trade behind the Iron Curtain than they have out in front of it on this side.

Well, we want to go into the NTT agreement and that is certainly one of the things that we will be looking forward to getting some more advice and counsel from you on. Thank you very much.

Mr. SODOLSKI. Thank you.

Chairman GIBBONS. The next witness is representing the R. J. Reynolds Tobacco International, Inc., Mr. Dale Sisel, who is the executive vice president. It is good to see you again, sir, and we welcome you here. I am sorry that you happen to be the last live body on the program today, but I know you have got a number of things to tell us about the horrors of the monopoly over there and some of their actions, so go right ahead.

STATEMENT OF DALE SISEL, EXECUTIVE VICE PRESIDENT, R. J. REYNOLDS TOBACCO INTERNATIONAL, INC.

Mr. SISEL. Thank you, Mr. Chairman, it is good to see you again, and we certainly appreciate having the opportunity to be here today and be represented on what we feel is a very important issue, indeed.

We in the tobacco industry feel that tobacco is perhaps the most clearcut example of protectionism in Japan, pure and simple. As you said, I am executive vice president of R. J. Reynolds Tobacco

International, and I do have general management responsibility for business in the Far East.

Our company is a subsidiary of R. J. Reynolds Industries who are involved in the manufacture, export, and sale of tobacco in over 160 countries around the world. I have submitted a statement for the record on our experiences over the past few years in trying to gain effective access to the cigarette market in Japan and would like to briefly summarize that statement for you.

Japan is the fourth largest cigarette market in the world, behind China, the United States, and the Soviet Union. In point of fact, it is the largest foreign market in which American cigarette companies can reasonably hope to get significant business in the near future.

Currently, almost 99 percent of the cigarettes sold in Japan are manufactured by the state-owned Japan Tobacco and Salt Public Corporation, generally referred to as the JTS. The JTS controls all aspects of the tobacco industry in Japan, including imported brands which account for only 1.4 percent of the total market. And when we speak of imported brands in Japan, we are speaking almost exclusively of American cigarettes.

Were it not for the number of tariff and nontariff barriers that exist, American cigarettes would enjoy a substantial share of the $10 billion market. I have seen projections of 20 percent, 30 percent or even 50 percent. While I cannot confirm nor would I dispute any of these specific numbers, I am convinced that those predictions broadly reflect the potential for American companies in this important market.

The reason for that confidence is that the cigarette produced by the JTS is an American blend cigarette. Japan, in fact, is one of the few foreign markets in which the American blend cigarette accounts for virtually 100 percent of sales.

The Japanese taste for ciagrettes is an American taste. About 30 percent of the tobacco used in Japanese cigarettes is imported from the United States, not because the Japanese cannot grow enough of their own tobacco, but because high quality American leaf must be blended with the lower quality native leaf in order to satisfy consumer tastes. So, there is a ready market for imported American cigarettes in Japan, but we are unable to take advantage of it because of trade barriers that fall into four categories. Pricing, distribution, advertising, and marketing.

We are subjected to a tariff which is unjustified and which significantly inflates the retail price of our brands compared to Japanese brands. Our brands are only allowed to be sold in 8 percent of the licensed tobacco retailers in Japan. We are under severe advertising restrictions which do not apply in the same way to Japanese cigarettes, and we are prohibited from doing effective consumer research and test marketing of our new products.

In the interest of time, I will refer you to my written statement for the details of the trade barriers we face and of the efforts that have been made through the Office of the U.S. Trade Representative during the past 3 years to remove them.

I would like now, if I may, to move directly to the purpose of my appearance here today. In January of this year, in conjunction with the visit of Prime Minister Nakasone to the United States, the Government of Japan announced two measures which could be the most significant steps yet in our effort to gain meaningful access to the Japanese cigarette market.

One would reduce the current tariff on our product from 35 percent to 20 percent, and the other would accelerate our access to licensed cigarette retailers in Japan. If fully implemented in the spirit which we believe the Prime Minister offered them, these measures could have a clear, immediate and direct impact on the competitiveness of American cigarettes in Japan.

Let me emphasize, however, that they would constitute only a positive first step in dismantling the wide array of tariff and nontariff barriers we now face. But we have had promises before. We have no reason to doubt the sincerity with which they were made, but somehow in the process of their implementation, these promises have been largely unfulfilled.

It is important to understand in this regard that the JTS is in a classic conflict of interest situation, and in the anomalous position of being our regulator, our distributor, and at the same time, our only Japanese competitor. Every share point we gain in that market will come at the expense of the JTS. With that fact in mind, it is not difficult to understand why the JTS has been, at best, luke warm and at worst, openly obstructionist in implementing the market opening measures of the past.

I must be perfectly blunt and state that our past experience tells us that there could be a wide difference between the promises made in January and the actual implementations scheduled to take place in April. We hope that does not happen. We are more optimistic about these proposals than about any that have been put forward in the past.

We think there is an opportunity now for a turning point in our long and thus far largely futile effort to gain access to the Japanese markets. We hope the Japanese also see this as an opportunity to reduce the trade friction that now exists between our two countries.

I am afraid that our skepticism, however, is not just the result of past experiences. There are already some early signs that it may be justified once again. I am speaking specifically of persistent press reports from Japan that bureaucratic tinkering is underway to diminish or negate the impact of the tariff reduction promised by Prime Miminster Nakasone.

If that tariff reduction is to improve our market position it must have two results. First, there must be a significant reduction in the retail price of American cigarettes, and second, a simultaneous reduction in the price differential between American and Japanese brands. Those are the criteria upon which the measure will be judged.

In the absence of any other actions affecting retail price, that tariff reduction should cause a 30-yen reduction in the retail price, and a corresponding 30-yen narrowing of the price differential. But we now understand that a 20-yen price increase for all cigarettes, both domestic and imported, is under serious consideration. It is now being referred to as a surcharge, although earlier press reports described it as a price increase to be applied to Japanese brands only.

If the JTS chooses to raise the price of its brands, it is, of course, of no concern to us. But there is absolutely no justification for such a price increase to be arbitrarily applied to American brands as well. None of that price increase would go to American manufacturers. Rather, American brands would be providing an additional subsidy to the Japanese tobacco monopoly.

More importantly, it would be a mechanism to allow the JTS to pass along its cost increases to the consumer without reducing the price differential with U.S. brands. The effect of this price increase would, after the tariff reduction, put American brands at the same 280-yen price they were 1 year ago. Additionally, the differential between the American-Japanese brands would be narrowed to only 80 yen rather than to 60 yen if the increase were applied only to Japanese brands, as originally intended.

We also understand that changes in the pricing formula are being considered in order to increase the profit margin for licensed retailers, and to reinstate a 1-percent internal reserve charge which the JTS agreed to forego last year. Each of these measures would add yet another 10 yen to the retail price of American cigarettes.

If all three of these actions take place, the net effect would be to put the retail price of our brands at about 300 yen or even higher than it is today, and the retail price differential would be about 100 yen, or only 10 yen lower than it curently is.

Mr. Chairman, if these or any other steps are taken to diminish the promised impact of the tariff reduction, the consequences, we feel, would extend beyond the dissappoinment of the American cigarette manufacturers.

The difficulties we have had in gaining meaningful access to the Japanese cigarette market have been widely reported in the news media. In many ways, this issue has become symbolic of the broader trade friction, which, unfortunately, has clouded relations between the United States and Japan in recent months.

If the promised trade relief incorporated in the most recent Japan proposal on cigarettes materializes, it could be seen as at least a first step in the easing of that friction. So it is not just from the standpoint of our own self-interest that we hope these measures will improve our competitive position in Japan.

R. J. Reynolds Tobacco International is a company which depends for its very existence on the principle of free and fair trade. That principle appears to be in some jeopardy today. We do not want to see our specific problems in Japan add to the festering disillusionment with the free-trade tradition of the United States. We are uncomfortable with the symbolism that has been attached to the cigarette issue, but the facts of this case speak for themselves loudly and clearly.

The discrimination we face in the Japanese cigarette market is the result of a system which can and should be changed. We will know in a few short weeks whether the recent proposals are a signal of this needed change.

In the meantime, I urge the administration, Members of Congress and the U.S. trade representative to continue to emphasize as strongly as possible to the Japanese Government the importance of full implementation of these proposals in the spirit in which they were offered. It should be made clear that if they are watered down, it will be a signal of a very different sort.

As in the past, we will continue to press for total elimination of all of the pricing, distribution, marketing, and advertising restrictions that we face in Japan. We believe they should be removed as soon as possible. But our immediate objective is to see that the most reent proposals are fully implemented. We believe it would be the most significant development on this issue to date.

Mr. Chairman, thank you.

[The prepared statement follows:]

STATEMENT OF DALE SISEL, EXECUTIVE VICE PRESIDENT, R. J. REYNOLDS TOBACCO INTERNATIONAL, INC.

Mr. Chairman and members of the subcommittee, my name is Dale Sisel and I am executive vice president of R. J. Reynolds Tobacco International, Inc. We are a subidiary of R. J. Reynolds Industries, Inc. involved in the manufacture, export and sale of cigarettes and other tobacco products outside the United States. We currently do business in about 160 countries and territories around the world. I have general management responsibility for our business in the Far East.

R. J. Reynolds Industries, our parent company, had sales and earnings last year of $13.1 billion and $870 million, respectively. About 37 percent of the corporation's sales and 20 percent of its earnings were generated by international trade activities. Of $10.7 billion in assets, more than 26 percent are devoted to international commerce. About half of the corporation's 100,000 employees live outside of the United States.

I appreciate the opportuinity to be here today to describe for you our experience in one of our markets—Japan. I will give you some background on that market, the current position of American cigarette companies in that market, a review of our efforts to gain access to it, and what we believe must take place if we are to have a reasonable opportunity to effectively market our products in Japan.

My testimony today must, in all fairness, be considered in light of the fact that measures were announced earlier this year by the Japanese Government to lower the import tariff on American cigarettes and to provide broader distribution of those products in Japan.

We believe it is extremely important that these measures are fully implemented. I will have more to say about those measures later. We are optimistic that they will have at least some impact, but we know that additional substantial steps must follow in order to eliminate all the trade barriers we face in that country.

Let me begin with some background on the Japanese cigarette market.

It is the fourth largest cigarette market in the world, behind China, the United States and the Soviet Union. In reality, it is the largest foreign market in which we can reasonably hope to do significant business in the near future.

It is potentially an extremely promising market for American cigarettes. About 308 billion cigarettes are sold in Japan each year. That is about half the volume sold in the United States. Japan has one of the highest smoking incidence rates in the world, significantly surpassing even that of the United States.

Currently, 98.6 percent of the cigarettes sold in that market are manufactured by the state-owned Japan Tobacco and Salt Public Corporation (JTS). It is a manufacturing and distribution monopoly which totally controls the tobacco industry in Japan from the pruchase of tobacco leaf to the licensing of cigarette retailers. That control extends to imported cigarettes as well.

Those imported cigarettes account for only 1.4 percent of the market. When we speak of imported cigarettes in Japan, we are speaking almost exclusively of American cigarettes. American brands account for about 98 percent of the tiny imported segment.

Were it not for the various trade barriers which I will describe for you in a moment, American cigarettes would enjoy a substantial share of the 10 billion dollar Japanese market. I have seen predicitons of 20, 30, even 50 percent within a few years of free access to the market. I cannot confirm nor would I dispute any of those specific numbers, but I am convinced that those predictions broadly reflect the potential for American companies in Japan.

The reason for that confidence is that the cigarette produced in Japan is an American-blend cigarette. In fact, it is one of the few foreign markets where the

American blend cigarette accounts for virtually 100 percent of the market. The Japanese taste for cigarettes is an American taste.

About 30 percent of the leaf tobacco used in Japanese cigarettes is imported from the United States, not because the Japanese cannot grow enough of their own tobacco, but because American tobacco must be blended with native, lower quality tobacco to satisfy consumer tastes.

Two years ago the number of retail outlets allowed to carry American cigarettes was increased from 14,000 to 20,000. Within 6 months, sales of American brands increased more than 20 percent. We think that is an indication of what would happen if we had free access to that market. (I should point out that coming from such a small base, that 20 percent increase had an infinitesimal impact on our total volume.)

American companies are not able to take advantage of the ready market for their products because of tariff and nontariff barriers that fall into four categories: pricing, distribution, advertising, and marketing. Let me go through each of those areas for you.

The first is pricing. Imported American brands are now priced 110 yen (or about 45 cents) above comparable Japanese brands even though we deliver them in Japan at about the same price as the cost of those cigarettes manufactured by the Japanese monopoly. This artificial price differential results from the combination of a 35 percent tariff and a complex pricing formula applied to our products by the monopoly. Because the tariff is applied at the top of the pricing formula, its effect is multiplied by the taxes and other charges that are part of that formula. This multiplier effect results in an effective tariff rate not of 35 percent, but actually 103 percent of CIF.

We contend that the Japanese cigarette tariff itself is unjustified, and that it is a protectionist measure.

First, it is not used to promote local manufacture by foreign companies. In Japan, no foreign company is permitted to manufacture cigarettes.

Second, it is not needed to shelter an infant local industry. The Japanese tobacco monopoly was formed almost 80 years ago to help fund the Russo-Japanese War. Its unit volume exceeds that of R. J. Reynolds' domestic and foreign volume combined. If it were a private corporation, it would be the worlds third largest cigarette manufacturer.

And third, it is not needed to conserve a short supply of foreign exchange. As one of the world's foremost trading nations, this is not a problem for Japan.

The recent announcement that the tariff would be reduced this spring from 35 percent to 20 percent may offer some relief from this pricing disparity. Until we see how that reduction works in combination with the other elements of the pricing formula, however, we simply cannot assess its impact.

The second set of barriers we face is in the distribution area. All cigarette distribution in Japan is handled by the JTS, including that of imported brands. Also, any retailer wishing to sell cigarettes must have a license granted only by the JTS. Retailers who wish to sell foreign brands must have a special license.

There are about 250,000 licensed cigarette retailers in Japan. Only 20,000 of them—about 8 percent—are also licensed to sell imported brands. Eleven out of twelve are prohibited from selling our products. Thus, even those Japanese consumers willing to pay the premium price for our brands often have difficulty finding a retailer who carries them.

The method of distributing the product to the licensed retailers is another impediment. The JTS will deliver its own brands to a retailer in several separate lots during the month, providing the retailer with the convenience of inventory and cash-flow control. If that retailer also is licensed to carry foreign brands, however, he will have them delivered only once per month, and he must make a minimum order to receive any supply at all. If he runs out during the month, it is up to him to go to a JTS depot and pick up more.

We are charged a distribution fee by the JTS. That fee is part of the pricing formula I mentioned earlier. This fee is equivalent to 21 percent of our FAS Price. It is about three times the distribution fee we pay to the French and Italian monopolies, which provide us with total market distribution, not merely 8 percent market distribution as we now get in Japan.

Advertising is the third type of barrier we face. As with all personal pleasure products, choice of cigarette brand is heavily influenced by advertising. In Japan, foreign cigarette companies are limited to a certain advertising budget derived from a formula based upon their previous year's sales. In most markets, we are free to invest in advertising as a means to increase our share of market. In Japan, that freedom is severely limited because our small share of market does not entitle us to spend at levels which would increase that share. Last year, for example, we were limited to approximately $600,000. Because of its 98.6 percent share, the JTS, our principal competitor, could spend more than $70 million, well over 100 times more than we could spend.

There are other examples of "Catch 22' to the advertising restrictions. The most effective advertising medium in Japan is television, and cigarette advertising is allowed. However, up until April of 1981, American companies were prohibited from advertising on television in the Japanese language. We were forced to advertise in English, if we chose to do so at all, which of course we didn't.

Television advertising, however, is limited to so-called "new" brands, defined as brands that have been in the market for less than three years. By the time the ban on Japanese language advertising for American companies was lifted 2 years ago, all our major brands had been in the market more than 3 years, so again we were kept off the air.

In reality, even if these last two complexities did not exist, we would not have access to television for another fundamental reason. We could not afford it. There is another regulation which says that only one-third of a company's total advertising spending limit—the limit determined by previous year's sales—can be used in television. For RJR Tobacco International, that would mean about $200,000 last year to reach a population more than half the size of the United States.

As you can see, advertising is readily available to our principal competitor, but only marginally so to American brands.

It is clear that the rules have been drawn to favor the status-quo in the market; to inhibit American brands from making their presence known in that market.

Fourth and finally, there is the matter of marketing restrictions. Consumer preferences change, and a successful company must adapt its products or introduce new ones to keep abreast of those changes. It is extremely difficult for American companies to do so in Japan.

For one thing, all proposals for market research must be submitted in writing to the JTS for approval. This is usually highly confidential and proprietary information, yet it must be provided to our competitor.

The JTS thus learns of our marketing plans and strategies before they are even tested, let alone implemented.

Additionally, we are not allowed to use retailers in our consumer research programs. We are not allowed to ask them to tell us consumer reaction to our products. Nor are we allowed to provide these retailers with economic incentives to help sell our brands—a fairly common practice in our industry throughout the world.

Most difficult for us in the marketing area, however, is the test market procedure we are forced to use. If we decide to introduce a new brand, we must provide the product to the JTS which then places it in test market in 60 retail outlets of its choice. That is, 60 outlets out of a quarter of a million. And these outlets are spread throughout the country, not in one centralized area, as is standard industry practice, so the product can be effectively supported with local advertising and point-of-sale materials.

In order for the JTS to agree to distribute the new product to all retailers licensed to sell American cigarettes, the brand must sell a specified number of units within several specified time frames. Frankly, it is not difficult to meet these criteria. The problem is that the introduction of the brand is delayed at least 6 months by the test market; the test market is unreliable and tells us little; and our competition has ample opportunity to study our new product and even our strategies for marketing it.

Mr. Chairman, that is the situation we face today in Japan. Our long-term goal is the elimination of those barriers.

Our position has been consistent throughout the years of discussion on this issue. We believe it is reasonable and fair to ask that we be accorded the same freedom to market our products in Japan that the Japanese tobacco monopoly enjoys there, and the same freedom in fact that the JTS has to market its products today in the United States. That is all we are seeking; nothing more.

In order for that freedom to be created, the following steps must take place:

First, the tariff, at whatever level, should be abolished. As long as American companies are not allowed to manufacture there, the tariff is an unjustified barrier, and violates the spirit of free trade.

Second, American cigarette companies should be granted open and equal access to all licensed retailers in Japan who want to carry American brands.

Third, American cigarette companies should be allowed to distribute their product to licensed retailers by whatever means they choose, whether through the monopoly or through arrangements of their own.

Fourth, American cigarette companies should be allowed to make whatever advertising investment they choose, and in whatever legally available media they choose.

Fifth, cigarette companies should be allowed to conduct their own market research without having to compromise their position by providing proprietary information to their Japanese competitor, and to test market new brands using accepted industry practices.

Through the untiring and much appreciated efforts of the Office of the U.S. Trade Representative, and with the support of Members of Congress, we have sought to achieve these five goals in negotiations with the Japanese for the past 3 years. There has been some small progress, but, in all candor, we have received mostly promises that have turned out to be false hopes. Let me briefly summarize the developments which have taken place.

The first of those was an agreement on imported manufactured tobacco products concluded by the United States and Japanese Governments in November 1980 and implemented in April 1981. It was this agreement that allowed us for the first time to advertise in the Japanese language, but it also imposed the advertising budget allocation based on the previous year's sales volume. The number of retail outlets where we could sell our products was increased from 14,000 to the current 20,000 (out of 250,000). for the first time we also had revealed to us the pricing formula used to determine the retail price of cigarettes, including interaction of the tariff and the formula.

More recently, during the past fourteen months the Government of Japan has announced three packages intended to "liberalize" United States-Japan trade. The package announced in January 1982 addressed a number of other trade barriers, but was totally silent concerning restrictions on imported U.S. cigarettes.

In the package of May 1982, trade in foreign cigarettes was included. The Government of Japan promised that all tobacco retailers would be allowed to handle foreign cigarettes, but that implementation would be in stages concluding in March 1986. In the interim, limitations on advertising expenditures were to be increased "to meet market situations," meaning that allowable advertising expenditures would be adjusted to reflect increased costs of advertising rather than providing an actual increase in effective spending levels.

The package further stated that the Government of Japan would consider accelerating the establishment of a Study Group "to assess and study the market situation of manufactured tobacco products in Japan and related matters." Nothing whatsoever was mentioned about the critical issue of the Japanese tariff on imported cigarettes. The first and only meeting of the Study Group was held in October 1982, without producing any movement on further reduction of trade barriers for U.S. cigarettes in Japan.

By the end of 1982—after the MAD agreement and the two trade packages that followed—the total impact on American cigarette companies in Japan was an increase in their share of market from 1.3 to 1.4 percent.

Then, in January of this year, in conjunction with the visit to Washington by Prime Minister Nakasone, the government of Japan announced its third and current trade package. This one addressed two areas of great interest to U.S. cigarette manufacturers—the tariff and retail distribution. The Japanese Government stated its intention to reduce the current 35 percent ad valorem tariff on imported cigarettes to a combined ad valorem and specific tariff equivalent to 20 percent. The increase in the number of licensed retail outlets allowed to sell foreign cigarettes, previously mentioned in the second package, is also to be accelerated to include all licensed outlets by March 31, 1985, a year earlier than previously scheduled, although the precise details of implementation are unclear at this time.

This third package is the most promising development to date. If fully implemented in the spirit in which we believe Prime Minister Nakasone offered them, these measures could have a clear, immediate and direct impact on the competitiveness of American cigarettes in Japan. Let me emphasize, however, that they would constitute only a positive first step toward the eventual removal of the whole set of trade barriers we face.

But we have had promises before. We have no reason to doubt the sincerity with which they were made, but somehow in the process of their implementation, those promises have been unfulfilled.

It is important to understand that the JTS is in a classic conflict of interest situation. It is our regulator and our distributor, and it is also our only Japanese competitor. Every share point we gain in that market will come at the expense of the JTS. With that fact in mind, it is not difficult to understand why the JTS has been at best lukewarm, and at worst openly obstructionist, in implementing the market opening measures of the past.

I must be perfectly blunt and state that our past experience tells us that there could be a wide difference between the promises made in January and the actual implementation scheduled to take place in April. We hope that does not happen. We are more optimistic about these proposals than about any that have been put forward in the past. We think there is an opportunity now for a turning point in our long and thus far largely futile effort to gain access to the Japanese market. We hope the Japanese see this as an opportunity to reduce overall trade friction, and take advantage of it.

I am afraid that our skepticism, however, is not just the result of past experiences. There are already some early signs that it may be justified once again. I am speaking specifically of persistent press reports from Japan that bureaucratic tinkering is underway to diminish or negate the impact of the tariff reduction promised by Prime Minister Nakasone.

If that tariff reduction is to improve our market position, it must have two results: There must be a significant reduction in the retail price of American cigarettes, and a simultaneous reduction in the artificial price differential between American and Japanese brands. Those are the criteria upon which the measure will be judged.

In the absence of any other actions affecting retail price, that tariff reduction should cause a 30-yen reduction in the retail price of our brands and a corresponding 30-yen narrowing of the price differential.

But we now understand that a 20 yen price increase for all cigarettes, domestic and imported, is under serious consideration. It is now being referred to as a "surcharge" although earlier press reports described it as a price increase to be applied to Japanese brands only.

If the JTS chooses to raise the price of its brands, it is of no concern to us. But there is absolutely no justification for such a price increase to be arbitrarily applied to American brands as well. None of that price increase would go to American manufacturers; rather, American brands would be providing an additional subsidy to the Japanese tobacco monopoly. But more important, it is a mechanism which would allow the JTS to pass along cost increases to the Japanese consumer without reducing the price differential with U.S. brands.

At present, American cigarettes already make a disproportionately high contribution to Japanese Government revenues. A pack of American cigarettes provides 188 yen to the Government, compared to 102 yen by a pack of domestic Japanese cigarettes.

The effect of this price increase would, after the tariff reduction, put American brands at the same 280 yen price they were a year ago. Additionally, the differential between American and Japanese brands would be narrowed only slightly to 80 yen rather than to 60 yen if the increase were applied only to Japanese brands, as originally intended.

We also understand that a change in the pricing formula is being considered in order to increase the profit margin for licensed retailers on American brands from 8.5 to 10 percent. This would add another 10 yen to the price of American cigarettes.

We do not oppose a profit margin increase for licensed retailers. Currently they make only 8.5 percent on American brands and 10 percent on Japanese brands. This is actually a disincentive to handle American brands, and it should be rectified.

However, this is another example of how American companies are adversely affected by the complex pricing formula to which they are captive. If this retail profit margin increase were implemented independent of the pricing formula, the impact on the licensed retailer would be roughly an additional 3 yen per pack profit and the price of American cigarettes would rise by the same 3 yen.

Because of the multiplier effect that starts with the tariff and permeates the entire pricing formula, however, the actual impact would be 3 yen for the licensed retailer, but an increase of 10 yen in the total price of a pack of American cigarettes. Somewhere along the line, 7 yen are added. They would not go to the retailer, not to the American company, but to the coffers of the Japanese Government.

The third concern we have is that the JTS will reinstate a 1 percent "internal reserve" charge which it agreed to forego last year. This unjustified charge would translate into an additional 10 yen at retail in the price of American cigarettes.

If all three of those actions take place, the net effect would put the retail price of our brands at about 300 yen, even higher than they are today. And the retail price differential would be about 100 yen—just 10 yen lower than it is now.

Mr. Chairman, if these or any other steps are taken to diminish the promised impact of the tariff reduction, the consequences would extend beyond the disappointment of the American cigarette manufacturers. The difficulties we have had in gaining meaningful access to the Japanese cigarette market have been widely reported in the news media. In many ways, this issue has beome symbolic of the broader trade friction which, unfortunately, has clouded relations between the United States and Japan in recent months. If the promised trade relief incorporated in the most recent Japanese proposals on cigarettes materializes, it could be seen as at least a first step in the lubrication of that friction. So it is not just from the standpoint of our own self-interest that we hope these recently announced measures improve our competitive position in Japan.

RJR Tobacco International is a company which depends for its very existence on the principle of free and fair trade. That principle appears to be in some jeopardy today. We do not want to see our specific problems in Japan add to the festering disillusionment with the free trade tradition the United States established 40 years ago following the hard lessons of the protectionist era of the 1930's. We take no comfort in the prominence of our difficulties, nor in the symbolism that has been attached to them.

But the facts of the case speak for themselves, loudly and clearly. The discrimination we face in the Japanese cigarette market is the result of a system which can and should be changed. We will know in a few short weeks whether the recent proposals are a signal of this needed change.

I urge the Administration, Members of Congress and the Office of the U.S. Trade Representative, to emphasize as strongly as possible to the Japanese Government the importance of full implementation of these proposals in the spirit in which they were offered. It should be made clear that if they are watered down, it will be a signal of a very different kind.

As in the past, we will continue to press for total elimination of all of the pricing, distribution, marketing and advertising restrictions that we face in Japan. We believe they should be removed as soon as possible. But our immediate objective is to see that the most recent proposals are fully implemented. We believe it would be the most significant development in this issue to date.

Thank you.

Chairman GIBBONS. Why do the Japanese have this tobacco and salt monopoly?

Mr. SISEL. The tobacco and salt monopoly in Japan dates back 80 years to the Russo-Japanese war. Why it has continued in existence for this period of time I am not really certain. One possible reason for it would be the fact that, as in the United States, there is a strong agricultural lobby in Japan. Tobacco farmers, of which there are something like 110,000, constitute an important constituency. Also, the monopoly employees about 35,000 people within the manufacturing and distribution system throughout the country. The Japanese Government has a vested interest in protecting that industry and the employment that goes along with it.

Chairman GIBBONS. Of the other developed countries in the world, do we run into this type of monopoly? You sell in other developed countries; do you run into this kind of monopoly anyplace else other than in Japan?

Mr. SISEL. We do, sir. In Europe, for example, there are tobacco monopolies in a number of countries including France, Spain, and Italy. But these monopolies are of a somewhat different character.

Chairman GIBBONS. All the losers. Go ahead.

Mr. SISEL. As I said, monopolies in those countries are somewhat different in character. I cited three in Europe. In all three, we have 100 percent distribution at a much lower cost and far more efficient way. The obstacles we face to compete in these markets are far less than they are in Japan.

Chairman GIBBONS. Do we force the Japanese to sell any of their products through any monopoly in this country?

Mr. SISEL. I am not aware of any.

Chairman GIBBONS. Have they ever complained when you have talked to them about this monopoly, that we force them to do something like that in this country?

Mr. SISEL. I have never heard a complaint in that regard at all, sir.

Chairman GIBBONS. Have you ever asked them why you have to deal through the monopoly, why you can't sell your cigarettes through your own distribution system?

Mr. SISEL. We have asked the question many times because in our industry it is as important as it is. Japan is a very large market and potentially a very profitable market for us.

The response is what I would call a stock response—that is, Japanese law provides for a Japanese monopoly. Therefore, they—the JTS— are powerless to anything about it.

Chairman GIBBONS. Well, they can change their law.

Let me ask you, would you or the other tobacco companies be prepared to distribute through your own system over there if they repeal their law requiring you to deal through their monopoly?

Mr. SISEL. The answer to that question, Mr. Chairman, is a very clear one. We regard Japan as potentially a very attractive market, particularly if we could distribute. If we could manufacture freely in that market, we would be more than willing to make a major investment in either distribution, manufacturing, or both.

Chairman GIBBONS. Maybe we should tell them they ought to sell all their Toyotas, all their Nissans and everything else through General Motors, Ford, and Chrysler. This has got to be childish. I run into the same thing with the cigars that are manufactured in my district. I know the markup on them is horrendous. The markup does not seem to be as great on your cigarettes as it is on my cigars, and maybe I ought to be pounding on the table even-harder than I have with that monopoly on that.

But I am fed up with the monopoly. I do not think they ought to make us sell our products through their monopoly. That is my position. Your industry and the cigar industry, and if we sell them any salt, I do not think we should be selling it through that monopoly, either. They can have their monopoly inside their country, but that is an unfair trade practice, as far as I am concerned.

I will do what I can to make sure that we are not treated unfairly.

Mr. SISEL. I appreciate your interest. I think right now is a very critical time, indeed, in the implementation of the Nakasone proposals both with regard to the tariff and with regard to distribution. We are getting quite a few signals, and I am sure you have heard the same ones, that the Japanese monopoly is looking at ways of getting around or diluting the positive impact that both of these measures would have on our business.

I think it is vitally important that if we are going to be successful in getting the full benefit of those measures, that the point be made again to the Japanese Government that we are serious about seeing them carried through in the way that they were put forth.

Chairman GIBBONS. Well, it is pretty obvious that what they gave with one hand, they are attempting to take away or planning to take away with the other in the increase in prices and the differentials and things of that sort.

But basically, I do not see why we ought to have to distribute through their monopoly. I think that is something that we should not tolerate, and we ought to get it straightened out with them real quick. There may be something else we can do, there may be some other product. Maybe we could require them to sell all their electronic goods through our own monopoly—well, not a monopoly, but our own distributors over here or our own manufacturers over here.

This is an intolerable situation, whether it be cigars, cigarettes, or anything else. I do not see how they get away with it. I do not know why we have allowed them to get away with it, frankly. Why have we allowed them to get away with it?

Mr. SISEL. I wish I had an answer. It is a $10 billion industry. We are currently running a positive trade balance with the Japanese on tobacco because ever though they are perfectly free to market or manufacture their cigarettes in this country—and as a matter of fact, on a small scale they do market their cigarettes in the United States—it has never been a major item. I see our failure to penetrate the Japanese market as an opportunity cost, or if you will, a lost opportunity.

I think we could, if given reasonable access to that market, have a substantially positive trade balance with the Japanese on tobacco.

One point if I could, Mr. Chairman. You referred earlier to the effect of the tariff on cigars and pointed out that the price of cigars in Japan was much higher than the selling price of the U.S. manufacturers to the Japanese monopoly. I might just mention that on cigarettes we are faced with much the same thing. The tariff is currently 35 percent, supposedly going down to 20 percent very soon if the Japanese take no offsetting measures. But if you look at our selling price to the Japanese monopoly and then compare that to the retail price, there is a 4½-fold difference.

In other words, the retail price of a package of U.S. cigarettes is 4½ times higher than the landed cost of those cigarettes to the JTS. Part of this is excise tax; part of it is a multiplier effect on the duty that is applied. But you can see what it does lead to in terms of our competitiveness or lack thereof.

Chairman GIBBONS. Well, I appreciate your coming and waiting here all day, and I am sorry you happened to be the last witness, but you have an interesting story and I think you are very deserving of a remedy. Thank you very much.

Mr. SISEL. Mr. Chairman, I appreciate the opportunity of being here, and thank you very much.

Chairman GIBBONS. Well, this concludes the hearings for today. I go back to my office and go to work. We are going to have some more hearings later on this same topic. We are going to pick up those witnesses that were scheduled for today that we could not possibly reach.

The hearing record will remain open until that time. The hearing is adjourned.

[Whereupon, at 4:55 p.m., the hearing was adjourned, to reconvene at the call of the Chair.]

UNITED STATES-JAPAN TRADE RELATIONS

THURSDAY, APRIL 21, 1983

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 1100, Longworth House Office Building, the Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. As we welcome our witnesses back this morning, let me explain that the chairman was downtown talking to a group of journalists and the questions ran a very long time. I apologize for arriving a couple of minutes late.

I have an opening statement here, but I will repress myself. You all know what the hearing is about, examining the United States-Japanese relationship, particularly looking at it in light of our trade laws and how we can improve our trade laws.

As I have said in other hearings, and in this related series of hearings, this year I hope we can do some things about what is generally recognized as being the unfair trade practices; trade practices that fall under the General Agreement on Tariffs and Trade subsidies, or dumping practices. But the testimony this morning is certainly not limited to that.

Mr. Sprinkel, we know that you have a deadline you must meet so we will take you first. Then we will see what happens after that. Go right ahead, sir.

STATEMENT OF BERYL W. SPRINKEL, UNDER SECRETARY FOR MONETARY AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. Sprinkel. Thank you, sir.

Mr. Chairman, distinguished members of this Subcommittee on Trade, I am pleased to have the opportunity to discuss again with your subcommittee the relationship between the dollar and the Japanese yen. In my November testimony, I made several observations which I will briefly review.

One, the weakening of the yen against the dollar at that time, was not unique, nor is it now. The dollar had appreciated against all major currencies including the yen. Also, we found no evidence that the Japanese authorities were manipulating markets to weaken the yen.

In fact, on the contrary, Japanese macroeconomic policies, foreign exchange market intervention, and reluctance to lower the official discount rate all suggested that Japanese authorities sought a stronger yen.

Factors contributing to continued yen weakness and dollar strength included weaker-than-expected Japanese external performance, including a decline in export volume; continued pressures in major markets for protection against Japanese exports; large capital outflows from Japan, stemming in part from recent liberalization of Japanese capital markets; a continued safe haven demand for dollars in the face of continuing uncertainties in the international debt situation; and, finally, dramatic improvement in U.S. inflation performance.

Since November there have been several developments I would like to mention. Since its low of 278 yen per dollar in early November, the yen has risen to 237 per dollar on April 19. This represents a 14-percent appreciation of the yen against the dollar from its November 1982 low.

For the calendar year to date, the dollar has been fairly strong against all major currencies, but it has been least strong against the yen. While the dollar has appreciated 9 percent against the French franc, 5 percent against sterling, and 2 percent against the Deutsche mark, it is up only 1 percent against the yen.

The Japanese authorities have maintained short-term interest rates in the 6-percent range despite an easing of interest rates in Europe and some calls for easier monetary policy in Japan. We continue to believe that differences in economic performance of the major economies are the primary factors influencing exchange rate developments and that greater stability in exchange markets, which we all want, can be achieved only through greater convergence of economic policies and performance among countries.

The key elements in such convergence should include sustainable noninflationary economic growth, open markets for goods and capital, reliance on markets to provide signals for the allocation of domestic and international resources, and less interference by governments in the economic decisionmaking process.

Over the last 2 years there has been substantial progress. Many countries have now made significant progress in reducing inflationary pressures, a key part of the basis for a sustainable recovery. We are beginning to see recovery take place, not just in the United States, but abroad as well and expect that it will gather strength over the course of this year.

What is needed now is assurance to markets that major countries will not shift toward excessive economic stimulus just as the hard-won gains against inflation are, at long last, being realized. Because an important element in achieving the lasting stability in exchange markets, which we all desire, includes greater openness in trade and capital markets, we have placed strong emphasis on this issue in our discussions with Japanese officials. It is important to an open trading system that Japan liberalize its markets, to allow full foreign participation in trade and investment activities.

Complete liberalization of the Japanese goods and capital markets would achieve two objectives. It would greatly improve market opportunities for U.S. firms, which we consider very important, and the exchange rate of the yen would reflect a more complete integration of the Japanese and world economies.

While we should acknowledge the progress made in some areas, the United States should and will continue to press Japan for further movement on these basic points. At the same time, we must resist pressures for short-term measures which would be, in our opinion, counterproductive and against our longer term interests.

Examples of such measures that some seem to be pushing include the following:

First, an import surcharge on goods from Japan. Such a protectionist measure would be a violation of the GATT's most-favored-nation principle and would represent a significant step away from the U.S. commitment to free trade.

Second, pressure on Japan to impose restrictions on capital outflows. Removal of controls of all kinds on the Japanese capital market will help promote increased internationalization of the yen and will result in greater access by foreigners to Japanese capital. To pressure the Japanese to pursue stop-go policies in this area would simply frustrate the long-term goal of liberalization and would increase market uncertainty about freedom of access to Japan's capital markets.

Another proposal is an adoption of exchange rate targets supported by intervention. The sheer volume of foreign currency transactions in the world market makes it costly to try to influence the direction of exchange rates consistently in one direction or another and impossible to influence them for very long. Moreover, such efforts assume that government officials are somehow endowed with better judgment than the marketplace as to the appropriate level of exchange rates, an assumption I consider highly questionable.

My remarks today and in my earlier appearance are not intended to downplay the competitive difficulties facing U.S. firms in part as a result of the strength of the dollar. However, as I have tried to indicate, I believe that some of the factors responsible for recent instability in exchange markets—that is inflation and interest rate differentials, safe haven considerations, balance of payments positions and differences in major countries' economic growth rates—are moderating. That is, we are beginning to get some convergence of economic results.

Other questions, such as liberalization of trade and capital flows are being addressed consistently and forcefully in discussions with our major trading partners. In addition, improved inflation performance in the United States, expected productivity gains as the recovery progresses, and continued success in controlling unit labor costs will work to strengthen the ability of U.S. producers to compete in domestic and world markets.

We believe that lasting progress on the fronts I have outlined, in the environment emerging of renewed economic growth, will offer U.S. firms the greatest potential for regaining their long-term competitive position.

Thank you, sir.

Chairman GIBBONS. Thank you.

Mr. Sprinkel, before we go to the other witnesses, we will talk to you first, so that you can meet your urgent appointment this morning.

Basically, Mr. Sprinkel, there is nothing you say with which I disagree. I think it is a matter of emphasis. One of the things that I hope, and certainly I will not be so presumptuous as to try to set the agenda for Williamsburg, is that this item will be at the top of the agenda, because I think, of all of the trade-distorting factors that we have right now, the vastly overvalued dollar is the most significant.

All Americans are proud of the fact that their dollar is strong. All of us are proud that the dollar is the most sought-after currency. The dollar is the safest place to put your money. The trouble is, it has terrible economic impact and political impact within this country. It is perhaps the biggest underlying driving factor that is pushing protectionist type of legislation.

While I recognize that mere intervention in the market will not correct our problems, some of the other fundamentals you have talked about will, in the long term, correct them. So, I would hope that as you and the Treasury Department influence the agenda of Williamsburg, that this whole item will be pushed to the top of the agenda. It is something that we have to move on and move fairly rapidly, or our political consensus is going to be whittled away. We could end up with disastrous short-range political, protectionist policies, one of which is just the domestic content and there are all kinds of other ones out there lurking on the horizon.

We are in the worst shape in this area that I have seen the Congress in, in my 20 years of experience here. That is the reason for emphasizing your area. All of the preliminaries we have seen on Williamsburg show that this item is way down, if on the agenda at all.

When we went to Japan as a committee earlier this month, we took up, basically, two items with the Japanese. One was the undervalued yen/overvalued dollar matter we are talking about. We found that the Japanese wanted to do something about it. That was the one point of general agreement we could reach in our conversations.

The second was what we call unfair trade practices and, of course, that sparked a lot of heated controversy over those areas. But there was a consensus within the Japanese Government, starting with Prime Minister Nakasone, all the way down through his cabinet, that something should be done. Their solution and our solution may not be the same.

But what can you tell us about their most recent pronouncements? Apparently the Japanese central bank is now saying they want to do something. What is your observation? Do you know what they want to do?

Mr. SPRINKEL. I am quite confident that, as they indicated to you and they have indicated to me, they sincerely would like to see a strengthening in the yen vis-a-vis the dollar. I have no doubt about that, either in terms of their words or their actions.

Chairman GIBBONS. Some settling down of the wild fluctuations the yen takes.

Mr. SPRINKEL. They are concerned, as we all are, with the instability of exchange rates. That is, it continues to change the signals to exporters and importers. It is not costless. It is costly.

The Williamsburg summit will indeed spend a great deal of time talking about basic issues relating to the instability of exchange rates. I cannot tell you for certain what the themes coming out of the summit may be. That depends upon the heads of state. In terms of the preparatory work that has been going on, one of the important themes will be, we hope, a commitment by heads of state to conduct policies which will, yes, encourage economic development. That is very important.

As to job creation, we all have problems there; but we hope to emphasize the importance of sustainability, and of avoiding the mistakes that some of our predecessors have made—that is, overstimulus and then 2 or 3 years later, waking up with accelerating inflation, high interest rates and extremely volatile exchange rates and, hence, we have to do it all over again.

Almost all of us in the summit countries, certainly five out of seven, have made major progress in getting our inflation rates down. It is critically important that we keep them down, so that we will not induce further volatility in the exchange rate. So that is one aspect of the discussion that will certainly focus on exchange rate implications.

Another aspect that we expect to be developed, will be the rather obvious interrelation between trade and finance. It is obvious if we think about it, because they are sort of the flip sides of the same issue, and yet as we structure these discussions in international forums, we do not see much interface. We see trade meetings going on frequently with various groups, and we not only see, but participate in, finance meetings going on in other groups.

As you know, Secretary Regan announced a few days ago that he had extended invitations to finance and trade ministers from the G-7 countries to meet following the OECD meeting to discuss the important interrelations between trade and finance. That is not a definite part of the process of the summit, because, he had this idea for many months and it takes time to finally resolve the issues, but it is a theme that will be discussed at Versailles, indicating the importance of keeping our markets open in order to make it possible for the LDC's, for example, to service their debt. Many LDC's are in adjustment programs with the IMF, which they have worked out jointly with the IMF. The programs all differ a little, but essentially the LDC's are trying to get inflation down and trying to get exports up relative to their imports. And to whom will they export if we are all mired in recession? There is no one out there.

So getting growth is very important. But also, if we are to sustain that growth, we cannot, in my opinion, permit these obvious protectionist pressures to develop to the point that even with growth the markets are not available to the LDC's. We all have a very strong interest in keeping the international monetary system intact, but to keep it intact so that it can finance trade. That is what it is all about. It is not just good in and of itself.

So, there will be a great deal of discussion of how we can work together in the finance and trade area to encourage stability in the international monetary system and to make sure that the system services well the growing trade we all want.

So, the third item that may well come up, because it is a followthrough from the Versailles Summit, relates to what else can be done about getting stability in exchange rates. If we have coordinated economic results, I personally think that will go a long way in getting what we all want, that is, reasonably stable exchange rates. Some are of the belief that further measures would be helpful and, as you know, our Government proposed at Versailles that we should take a look at the results of all of the massive intervention that has occurred since the Bretton Woods system began to crumble in the early 1970's, and try to determine whether or not it was successful.

That report was completed last January. It has had extensive discussion since that time. There will be, as Secretary Regan indicated, a meeting of G-7 ministers to review the policy implications of the report which will be released later this month. So I feel confident that heads of state, finance ministers, and secretaries of state will certainly have something to say about the results.

So when you say the exchange rate issue will not be on the Williamsburg Summit, you may mean that we do not have a list of a long number of items, including that one, which will be reviewed. That is true, but what we do try to emphasize, is the interrelation between many of the factors that all of our governments are interested in.

Chairman GIBBONS. The reason I mentioned this being on the summit is, it seems to me, when heads of states get together, they can get bogged down on details, but they do not tend to bog down as much on recognizing the driving forces that our different currencies are having on their systems.

As I say, from our vantage point on the Ways and Means Committee, it appears to me now that the biggest single influence we are having on world trade is a very volatile, international monetary exchange system. Because it is volatile, everyone is turning to dollars. Because everyone turns to dollars, that means our exports are that much less competitive, and our imports are that much less competitive and, therefore, we suffer these horrible burdens upon our domestic industry cost by this monetary system.

I realize it is a very complex, interrelated, and chicken-and-egg sort of operation. But there is one thing, from my conversations with various heads of state, they do agree something is wrong and that seems to be the point of beginning.

Mr. SPRINKEL. Yes, sir, I agree with that. The thing that has been wrong, the most important thing that has been wrong, although I would not allege it was the only thing, has been variable economic results among the different nations of the world. That is, we now are moving from what, for us, was a period of very serious inflation; and during that period of accelerating inflation in the United States vis-a-vis the rest of the world, the dollar weakened enormously, which is what economic theory said should happen and, in fact, it did.

In the last few years we have done our best to get our inflation down and with marvelous success, even vis-a-vis most of the rest of the world. Now the new era that may be emerging, and I am hopeful but I do not know for certain, that the leading countries—most of the leading countries—are now at low levels of inflation so we do not have that shock that has been emanating through the system over the last decade or two.

If you look at the German economy, their inflation is in the low single digits. When you look at the United Kingdom, they are getting down below single digits. When you look at Japan, they have been in the low single digits since 1976 or 1977. They had a bout with inflation in 1974 but they promptly got it under control. In our own case, we are in the low single digits.

Chairman GIBBONS. It is a good thing you did not mention France.

Mr. SPRINKEL. I chose carefully. They have made some progress off of their highs, but they are still substantially more inflationary than most of their partners. Of course, the same would apply to Italy. Canada is making progress now. So, out of the seven, I would say five have made very significant progress and even the French have made some.

Chairman GIBBONS. You mentioned internationalization of the yen. How much has been accomplished? How much more needs to be accomplished in that area?

Mr. SPRINKEL. We do not think it has been completely accomplished, although significant progress has occurred. It is our judgment that, over the long run, further efforts to internationalize the yen will result in a stronger yen. Although, in the short run, it may have exactly the opposite effect.

Chairman GIBBONS. I agree.

Mr. SPRINKEL. That is, to the extent you make it easy for capital to flow out of Japan, this puts more downward pressure on the yen and you say, well, this is counterproductive. It is already too weak. But if you do not open up the market for yen and make it possible for companies to hold some of their reserves in yen or for nations to hold some of their reserves in yen, you will never make the yen an important world currency. It is not likely to be as important as the dollar if we conduct our affairs properly, but it can become much more important than it is now.

There has been over the last several years a significant easing on those restrictions on capital outflows, but they are not all gone. Not only do the words say they have eased, that is important, but the numbers say so as well—that is, the flows of capital coming out of Japan. Since 1980 capital outflows have stepped up substantially. In fact, some years ago the Japanese were very, extremely protective with the yen and they did not want it to become an international currency. After continued efforts by the United States, I hear less of that argument now, and the moves promised by the new prime minister are continuing to move in that direction, although they are not there yet. But I think we should continue the pressure and we are.

Chairman GIBBONS. Is it United States policy that we are continuing to urge the Japanese to internationalize their yen?

Mr. SPRINKEL. Yes, sir, it is certainly true in Treasury, that has the lead on the financial side, but our trade representatives and others that work with the Japanese carry the same message. So, I think there is complete coordination in this Government to encourage the Japanese to open up their capital markets further, as well as their goods markets.

Chairman GIBBONS. While we are concentrating on the Japanese this morning, I do not want to overlook the rest of the picture. Are we asking other countries to internationalize their currencies, too?

Mr. SPRINKEL. We are asking them to have free and open capital markets and many of them do not have. Most are not large enough, in terms of the world trade situation, to become a significant factor, but the German mark does.

Chairman **Gibbons**. The German mark?

Mr. **Sprinkel**. Certainly. They tend to have open markets, much more so than the Japanese. In our case, we have very open markets. Capital can flow in and out with no difficulty. But the Germans tend to be much more open and they have had a good record over a considerable period of time, and the mark plays a very important role, as you know, in Europe and especially in the EMS.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Thank you, Mr. Chairman. Thank you, Mr. Sprinkel. I know your time is limited or we could discourse at length here.

I would like to restate, just briefly, what the chairman said. Our interest in bringing exchange rates to the Williamsburg Summit is not confined to the chairman. It is shared by our subcommittee and probably by our full committee. We think it is shared by most of our trading partners and we expect that, no matter how the agenda is scheduled, that the exchange rate is going to be talked about, because that is what we might call a front burner issue.

Mr. Nakasone told us in Japan that while others were interested in getting daily reports on the stock markets and baseball scores, the first figure he looked at every day was the yen-dollar figure. It is of enormous importance to the Japanese and they understand our concerns, I think.

You are, of course, right. As we seek to internationalize the yen, the first loosening of restrictions, the first liberalization will only cause it to be weakened. Do you have any estimates as to how long that phenomenon might have to be endured on the road to a more reasonably priced yen.

Mr. **Sprinkel**. I really do not know for certain and to allege otherwise would be to mislead you. I think considerable progress has been made. The Japanese do have a low inflation and we are getting one. Therefore, I personally would expect considerably less volatility in the period ahead, if we continue in the present vein, than in the past in terms of levels of the yen vis-a-vis the dollar, which is extremely important.

We do know that they are running a sizable trade surplus despite all of the restrictions on the Japanese exports. We know their current account is moving into significant surplus. We know that in our case, both our trade deficit is growing and we are moving into a fairly significant current account deficit.

You might say, well does that not prove those markets will adjust with the yen going up and the dollar going down? It is certainly a force in that direction, but it is not the only force, and we cannot be certain there is not a close correlation—let me put it that way—between what happens to an exchange rate and what is happening to its trade and capital flows.

There will be some pressures downward on the dollar and some pressures upward on the yen because of that, but we cannot be certain that, in fact, the markets will work out. The rate in the marketplace is the one that equates the quantity of yen and dollars supplied with the quantity of yen and dollars demanded. So, trade is only one aspect, but an important aspect.

Mr. **Frenzel**. As you have looked at it, you have reported to this committee before that, given the rules as they exist, the yen and the dollar are at least in the relationship that the market chooses to put on them. What, in your judgment, should be the proper relationship if not 237 to 1?

Mr. **Sprinkel**. I am given frequent advice on where it should be. Many people find it easy to decide what the proper rate is. I find it very difficult to make that decision. I do not consider myself that brilliant. We have a very large market with many participants, and the rate that evolves is the one that does equate the quantity demanded and the quantity supplied.

You know, if we look at what has happened to the dollar-yen relationship over time, it is a little revealing that it still does not tell you what the right rate is. If you go all of the way back to 1973, when the Bretton Woods system finally tumbled, we see that the dollar has depreciated 10 percent vis-a-vis the yen from that day. So, the yen has gone up, the dollar has gone down.

On the other hand—and of course the performance of the yen is much different from that of most of the other currencies—if you look at the low of the dollar, that was during this period of accelerating inflation in the United States; and the low of the dollar against most currencies occurred on July 22, 1980. Since that time, the dollar has appreciated just under 8 percent vis-a-vis the yen, and the dollar has appreciated 41 percent vis-a-vis the German mark. It has appreciated 53 percent vis-a-vis the pound and 82 percent, of course, against the French franc.

Now, we have had the smallest appreciation since that day against the yen, but the dollar has appreciated. Was the right rate back in 1973, was it in 1980—I cannot believe 1980. That was a period when it was not at all clear we were going to get inflation down, and now we have got it down. It is not clear we will keep it down, but we will do our best to keep it down.

So, I just cannot, frankly, answer your question.

Mr. **Frenzel**. Well, I thank you for the careful evasion. [Laughter.]

You indicated that (*a*) you are opposed to intervention and that, (*b*) stability would be a good goal. I am inclined to agree. In general, I do not like intervention, although I think there are times, maybe, when it is warranted.

I guess I have the same feeling about stability. I do not think stability should necessarily be the goal of the system. I think a proper relationship between the various currencies should be the goal and if they are going to fluctuate and if the economies are going to fluctuate, instability in the system is something that does not belong there. I wonder if you would comment.

Mr. **Sprinkel**. First, we do not have a policy of no intervention.

Mr. **Frenzel**. I understand that, but I thought from your statement you were not excited about intervention.

Mr. **Sprinkel**. That is indeed true, and I think fundamental forces are much more important than intervention, but we are committed to intervening when we view markets going into a disorderly mode. And we have intervened on several occasions.

There have been a large number of additional occasions when we were all set to intervene and the markets, all of a sudden, smoothed out; and it looks as if it would have been a destabilizing act to try to impose our will. So, we are prepared, and will continue to be prepared to intervene. I am sorry, would you repeat the last part of that. It has slipped my mind.

Mr. FRENZEL. You indicated stability was one of the goals and I had some concern that stabilty rather seems to me to be the prime European goal, but in a free market, stability is not the only thing and it may be the least important.

Mr. SPRINKEL. Yes, it is indeed true. We all have independent governments and, therefore, we choose our own policies. Now having said that, I think there is growing recognition in all of the governments that what we do as an individual nation has a bearing on what happens in other nations. Therefore, we should take into consideration, in choosing our own policies, the impact it will have on the rest of the world.

As you know, the EMS, which was set up in 1979, is an attempt to create some stability by having reasonably fixed exchange rates with a little variability, but not much. And they intervene in a significant way trying to maintain that stability. We all want the stability.

Now the fact that on five different occasions since 1979, including very recently, there were massive capital flows, massive intervention and eventually a restructuring of the EMS, suggests very clearly that they did not have coordinated results in their economic policies. Rather than trying to impose stability on an unstable world, which would not work, what we are urging is to let us do our best to recognize the impact of our actions on others as well as our actions on our own citizens.

In this case I do not see any inconsistency in trying to achieve low inflation and keep it there—there are lots of domestic reasons for doing that; there are many international reasons for doing it. But at the same time as inflation comes down, we will do everything we can to stimulate real growth in a sustainable way. That is where we are trying to put the emphasis.

We have never said that under all circumstances we will reject some kind of stable exchange rate system. If we can ultimately get this coordination of economic results, we can think about that possibility. It is a long process and we are not ready to move there yet. Secretary Regan has indicated lately that it does not make much sense to move there now when we do not have similar results in terms of performance of the economies. We are getting there, as I indicated, but we are not there yet.

Mr. FRENZEL. I thank you. My last question is, some of our more theologically minded friends tell us that gold is the solution. I presume you do not follow that blind philosophy.

Mr. SPRINKEL. I watch the gold market very carefully. I think it is a good indicator. I watch exchange markets very carefully and commodity markets very carefully, because all of these markets have had a good record of sensing important prospective price changes.

If we were in a situation where gold was rising rapidly and commodity prices were rising rapidly and all of the indicators of inflation were flashing, that would say something to me.

Fortunately, in the present situation, we have reasonable stability in those markets—some volatility, but not bad. We do expect some commodity prices will move up off their bottoms, because they took a very sharp drop over the past couple of years, including some of our own agricultural products. That would not mean we are going back to inflation, but I would expect as economic growth improves, we will see some firming in some of those markets.

I do not believe at this point that gold will give us a magical solution. You cannot substitute gold for a commitment by our governments to get our fiscal and monetary policies under control and keep them under control.

It is political will that is important, not the system. We can make several systems work, but none of them will work if we do not have the political will at home and abroad to keep our inflation, brought on by adverse monetary and fiscal policies, under control.

Mr. Frenzel. Thank you very much.

Chairman Gibbons. Mr. Jenkins.

Mr. Jenkins. Thank you, Mr. Chairman, Mr. Secretary. Thank you for your testimony.

Specifically, what has Japan done in the last few months to attempt to correct this imbalance we are plagued with?

Mr. Sprinkel. They do not release their intervention figures. Therefore, I cannot present them. But they do release reserve figures, which includes intervention as well as some other factors.

Those numbers have indicated many billions of dollars—reduction in reserves, and much of it due to significant intervention. Now, it has not worked. But, then, significant intervention with no policy change never works. So, this is not a new phenomenon. It has happened many times.

Now, there have been some important promises by Prime Minister Nakasone concerning trade liberalization, and I think my partners are more qualified to talk about that than I. Words are one thing, deeds are another; and we welcome that indication that he was willing to move in that direction and that he was introducing laws that would make it possible.

But we continue to monitor the situation and there have been actions on the capital front, but I just have no doubt that, as the chairman I suspect found out in Japan, they want that yen up and they do not know quite how to get it there.

Mr. Jenkins. What are short-term and long-term interest rates now in Japan?

Mr. Sprinkel. In general, their interest rates are on the low side, consistent with the fact that they have been on the low side with inflation for many years, say, starting in 1977, something like that.

Mr. Jenkins. Does that have any effect in overstimulating the economy?

Mr. Sprinkel. Well, there is a running debate, as you know, about how you get low interest rates, and I do not want to get too deeply into that subject, other than to say that, in my judgment, there is no way of getting low interest rates unless you have low inflation. You cannot keep them down. They have got low inflation and they are doing everything they can to make sure they keep it there.

The head of the central bank, Mr. Mackawa, gave a speech within the last few hours. I saw the report this morning indicating their desire to keep the money supply under control so that inflation does not become a serious problem in Japan. So, they are doing that. They are doing their best to keep inflation down and in that event, interest rates will stay relatively low.

Now, if you look at real interest rates, and in Japan's case I think they are fairly easy to measure, they are fairly high. By real interest rates, typically is meant the nominal interest rate and subtracted from that, the inflation rate.

Now, their inflation rate has been low for many years. Therefore, I think that is a fair computation, because their actual rate of inflation is very near the expected inflation rate, probably because of the long tenure of low inflation. If you measure their real rates, in that sense they are quite high.

Now, in our case, ours are a little higher, but I suspect it is an improper measurement in our case. That is, if you take the actual interest rates in the United States and subtract the actual inflation, it yields extremely high real rates, one of the highest in my lifetime.

But I do not believe that computation, because my own view is that the marketplace and the American people and others in that market do not, at this moment, believe that our actual inflation rate will continue at its current low level. That is, the actual inflation rate in the United States is below the expected inflation rate. Hence, it is a little unfair to make the comparison between United States and Japanese interest rates, because I have less confidence that such a comparison will yield a real interest rate in our case than I have that it will yield a real rate in the Japanese case.

But the Japanese have relatively high real interest rates and there is great political pressure in Japan, as I am sure you are aware, to try to pull those rates down somewhat further. There is a debate within the Government as to whether they should cut the discount rate, trying to encourage a lower rate.

The great concern of many is, if they were to do that, and therefore reduce both their nominal interest rates and their real rates, that would result in even greater weakness in the yen. It probably would if nothing else happened. So, they have low interest rates nominally vis-a-vis most of the rest of the world because of low inflation. Even so, they have fairly high real rates compared to most countries.

Mr. **Jenkins**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Mr. Shulze.

Mr. **Schulze**. Thank you, Mr. Chairman, Mr. Secretary. We are pleased to have you here today. I think the chairman put his finger on part of the problem when he stated there is growing protectionist sentiment in this country. I think we all agree one of the major causes of that is the imbalance of the dollar.

If our goal is to stimulate and sustain growth, as you have stated, so that we can open these markets, it seems to me we have to cure the imbalance in the ratio of the dollar versus the yen and other major currencies. And if we can, for a moment, just go into the realm of fairy tale, perhaps, and say the President called you and Secretary Regan in and pounded on the desk and says if we are to sustain growth, we must have exports, and if we are to have exports, we must do something about the imbalance of the dollar, because we are losing jobs because of it here in our country—I do not want to hear anything—but I want you to go out of this room and do something about this.

With the realization that this is speculation, what would your actions be?

Mr. **Sprinkel**. I would suggest with great care, since I would be talking to the President of the United States, that these may be inconsistent goals in the short run. That is, I am confident we can get—we could—if we pursued a particular type of policy, we could get the dollar down vis-a-vis the yen.

The way you do that, all history suggests—one way, not the right way, but one way—is to have a massive growth in our money supply, for example, vis-a-vis the Japanese and we would get the yen down; and it would be the result of an overt policy by the Federal Reserve Board.

But that will make it impossible to have sustainable growth, in my opinion. Inevitably, spending would start rising, incomes would go up, employment would rise in the short run and we all want those desperately.

But out there a year or two, I am absolutely certain it would lead to sharp acceleration in inflation, much higher interest rates and then we would be back to the same degree of volatility we had before. So, that would not be a viable option to achieve both sustainable growth and a weaker dollar, which is what you would like to have.

Now, there are things we can do to encourage openness of the Japanese market, which I previously discussed. Those, over the long run, will strengthen the yen vis-a-vis the dollar, I am convinced. If we can get the Japanese to open their markets so we can export more into those markets, it will have a long-term beneficial effect, but I do not think there are any quick fixes. I wish there were. We could certainly do them, but there are not any; and we have to learn from history and not repeat, I hope, the mistake many of our nations made some years ago when we thought we were going to solve the whole problem by putting the focus on growth with major stimulus. We got short-run growth, but we got a lot of headaches, and we do not want that to happen again. So, I am convinced that this President is committed. He was committed to getting inflation down. He is now committed to doing his best to keep it down.

Mr. **Schulze**. If we do not have this period of sustained growth, the LDC's and Third World countries will not have that market and they should not only look to us as a market, but other areas of the world as well.

We are viewed, of course, as the largest, richest market in the world and in most instances I think they concentrate on us rather than on some smaller markets where they could have greater penetration and I think that should be encouraged as well.

Mr. Secretary, in your statement, on the last page, you said other questions, such as liberalization of trade and capital flows, are being addressed consistently and forcefully in discussions with our major trading partners. I wonder if you could elaborate on that.

Mr. Sprinkel. Yes; I mentioned the initiatives that many arms of this Government have pursued with the Japanese. It has been a concerted effort. We in Treasury have placed heavy interest on the financial flow aspects, trying to help our trade people get their objective, which we think is also important.

We are urging in the summit process that one of the reasons for getting the recovery going, there are many of them, but one is a conviction that as markets grow, the inevitable protectionist pressures will abate a little. They will not disappear, but they will tend to become less severe, and all nations recognize that. We have had many debates in Europe and they are ongoing, and I am sure my trade partners will elaborate on them.

We were not very happy with the GATT results. In fact, we were distinctly unhappy and there are ongoing initiatives to try over the next few years to readdress those problems. So, we are trying to take a consistent position worldwide to keep open markets, because we think that it is in our interest, but it is also in the interest of other nations.

So we are not fine tuning one country and saying it is OK if you tighten up your credit markets or your exchange markets because it will help a little bit in the short run in terms of the exchange rate, but in the long run it is inconsistent. We are not doing that. We are trying to take an intermediate thrust and in the process work out arrangements which we hope are less unfair to our own exporters. I am sure my partners can elaborate on that in much more detail.

Mr. Schulze. I felt at the GATT Ministerial, perhaps we should have been more forceful, saying that legislation such as domestic content will progress. In trade, if you do not move forward, you are moving backward. I think we are moving backward. If that builds, it may be unstoppable. I do not know. I agree when the economy comes back it will lessen somewhat, but I think those pressures are growing as I go around the country and it will be very difficult to reverse it.

One suggestion which is going around through the corridors of these buildings is a currency imbalance surcharge.

I would like to have your thoughts on it. If there is a dramatic imbalance in currency, a tariff or surcharge would be leveled as an attempt to remedy that imbalance. It is being given some consideration, and I would like to have your thoughts.

Mr. Sprinkel. I have not seen the details of the proposal, but I presume you have to think in terms of how it will be operational, and I presume that some group of wise men or a wise man would decide what the right rate is for the dollar and the yen and then manipulate by surcharges of one kind or another to try to make it go there. I think that would be extremely unfortunate.

In the first place, I have no confidence that I or anyone else, other than what is going on out there equating demand and supply, can pick the right rate. If I were an exporter and I was getting hurt on those markets—and there are many who are—I would have an intuitive feel for what kind of rate I needed in order for my company to be competitive. But is that the rate that would clear in the market place, and should we impose restrictive actions by taxes, tariffs, quotas, and surcharges to make it go there?

I can understand why someone might argue that, but in terms of national policy, and that is what we are talking about, I find it very difficult to believe that that sort of proposal could be operational. It is true that purchasing power parity or something close to that over the long run is probably the best predictor, but it does not hold in the short run. As Mr. Keynes pointed out a long time ago, we live in the short run, so how do you make that idea operational?

I do not know. I could not make it operational.

Mr. SCHULZE. Thank you, Mr. Chairman. I have other questions, but I know the time is short.

Chairman GIBBONS. Mr. Pease.

Mr. PEASE. Mr. Chairman, I would like to ask the Secretary a couple of quick questions. One is on interest rates.

In Japan, as you have pointed out, they are significantly lower than they are here. Is it your understanding that the Japanese significantly intervene in setting interest rates more than our Government does?

Mr. SPRINKEL. I think that is probably true. We still have some controls on interest rates, but they are rapidly fading. They have some controls on certain types of savings rates. They are moving to reduce them, but they still have them.

They have certain rules concerning their banks buying Government securities at certain prices. Again, that is more intervention than is true of the United States. We are merging—they continue to move as we are moving, toward a freer market, which is a better deal for the saver and a deal that the institutions can afford as you liberalize their restraints on assets.

So, yes, the answer is yes. They do have more restrictions than we have, but they have a lot fewer than they had some years ago.

Mr. PEASE. If the degree of their restrictions was about the same as it is in the United States, do you have any guess as to what influence that would have on current interest rates?

Mr. SPRINKEL. For those that have ceilings on rates, and there are some presumably, if they remove the ceilings those rates would move up.

Mr. PEASE. How much?

Mr. SPRINKEL. I would be glad to take a look and make an estimate. What we would attempt to do would be to find a market rate that is not regulated and compare it with a regulated one. I do not have it off the top of my head, but I will do my best to get it to you, Mr. Pease.

Mr. PEASE. I would appreciate that very much.

Can you give me some kind of feel for how significant the restrictions on the inflow and outflow of capital are as far as the Japanese value of the yen is concerned.

Mr. SPRINKEL. Again, they are less than they were, but there are still some that exist. To our knowledge, there are no restrictions, at least we are not aware of them, on short term borrowing in Japan. The Japanese are free to move their funds out of Japan, much more so than before, I think mostly fully so.

There are still some remaining restrictions on the volume of bond sales in the Japanese market by foreign companies. The restrictions are not as intense as they used to be, but they are still there. Furthermore, the Japanese have the flexibility of tightening or easing them if they want to.

Japanese authorities also tend, with a few exceptions, to specifiy the kind of bond that can be sold. Typically, they do not like debenture bonds. They want a different kind of instrument, but recently they have backed up on that a little bit. They have let a few very high quality companies issue debenture bonds, but there are some remaining restrictions, and I suspect there are others than those I thought of quickly.

They are not there yet, but they are moving, and we keep the pressure on them.

Mr. **Pease**. Do you think they will continue to move over a period of time to a situation of relative freedom in inflow and outflow?

Mr. **Sprinkel**. I believe so. In discussions with Prime Minister Nakasone there was every evidence he was committed to this kind of move. In my conversations with finance people, they always go out of their way when they make a little move to make sure we know about it.

Of course, they are not quite so alert to do that when they move the other way. We have to find that out ourselves, but I think they are still moving and likely to move further.

Mr. **Pease**. Thank you.

Chairman **Gibbons**. Mr. Vander Jagt.

Mr. **Vander Jagt**. I have no questions, Mr. Chairman.

Chairman **Gibbons**. Thank you. I wanted to ask a couple of questions.

We had two very fine automobile makers in this country sitting where you are a couple of months ago saying they could compete against the Japanese if the yen-dollar relationship were between 180 and 200 yen to the dollar. Do you think we will get there?

Mr. **Sprinkel**. I am not certain. I am hopeful there will be some adjustment in these exchange rates, but I do not know what we can do overtly to make it happen in a hurry, consistent with sustainable growth.

Chairman **Gibbons**. I do not think you could intervene to that extent.

Mr. **Sprinkel**. No, sir.

Chairman **Gibbons**. I do not think a combination of intervention would bring it to that rate. It will take basic underlying economic factors.

Mr. **Sprinkel**. That is right. There are some things I think the trade people will indicate as to how the Japanese check automobiles when they go in; and that is a cost to our companies when the Japanese insist on looking at each one.

Chairman **Gibbons**. We are very familiar with that.

Mr. **Sprinkel**. They promised to move in that area and that would help.

Chairman **Gibbons**. But I am talking about in this market, not that market. We are really not making any effort to penetrate that market. The automobile companies said they could compete against the Japanese in this market if the exchange rate were somewhere between 180 and 200 to the dollar.

Mr. **Sprinkel**. That is a big change.

Chairman **Gibbons**. My question to you is based upon your feel for all of the factors, how long will it be before we get to that rate?

Mr. **Sprinkel**. I think it will be some time. It will especially be some time if the Congress, the administration, and the Federal Reserve remain dedicated to keeping this inflation down and getting sustainable growth. We could get there in a hurry if we did not worry about the inflation constraints.

Chairman **Gibbons**. If we wanted a quick fix, we could get that, but it would be destabilizing to our long-term economy.

Mr. **Sprinkel**. That is my opinion, sir. Yes, sir.

Chairman **Gibbons**. I agree with you. Thank you very much.

Mr. **Sprinkel**. Thank you, sir. I enjoyed it.

Chairman **Gibbons**. Now, if you all are not using those lights we would prefer you save electricity. Do you need those lights, particularly the ones shining in our eyes? [Laughter.]

All right. We move next to our friend and very effective Under Secretary of Commerce for International Trade, Mr. Lionel Olmer and our friend, the very effective Deputy Secretary of Agriculture, Richard Lyng.

We have Mr. Olmer first then we will go to Mr. Lyng and come back for questions. Is that the way you had prepared? You happen to be listed that way.

There is a 15-minute warning bell.

Mr. **Olmer**. I thought it was a signal the Japanese were ascending on me.

Chairman **Gibbons**. We should be that clear.

STATEMENT OF HON. LIONEL OLMER, UNDER SECRETARY FOR INTERNATIONAL TRADE, DEPARTMENT OF COMMERCE

Mr. **Olmer**. Thank you, Mr. Chairman, for the opportunity to appear before you. I have an elaborate statement I would like to introduce for the record, and I would briefly like to touch on some highlights.

Chairman **Gibbons**. All right, sir. Your statements will all be included in full in the record. Just go right ahead.

Mr. **Olmer**. Mr. Chairman, our economic relationship with Japan continues to be extremely important to both nations and deeply troubling. Despite several potentially significant developments in the past few months, many, many difficulties remain.

The most promising of the recent developments could be the clear and strong commitment of the Nakasone government to resolve trade problems. Among specific measures of progress that were announced in that connection are the acceptance by both governments of recommendations of the bilateral Work Group on High Technology Industries, and I am attaching to my written testimony an elaboration of this work group and its prospective activities.

Second, the Japanese effort to identify possible—and I would underscore possible—changes in import certification procedures, and further to channel problems that U.S. exporters face to a high level of authority in the Government of Japan. These kinds of developments hold out the promise of resolving trade issues, but we need to watch their implementation most carefully to see whether they deal with some fundamental underlying issues whereby foreigners have been and continue to be discriminated against.

For example, the Japanese Government targets industrial sectors and it nurtures them with numerous incentives in the clear recognition that foreign market share—U.S. market share—almost always is the ultimate objective. Intragroup preferences are routinely granted to members of the keiretsu. The formal approval of cartels and informal encouragement of industry consortia continues.

High tariffs and quotas remain on key U.S. exports despite liberalization packages of the last 2 years. The complex distribution system acts as an impediment to foreign sales. Finally, investment is impeded by the difficulty foreigners experience in trying to acquire Japanese companies.

Over the last nearly 18 months Japan has introduced a series of trade packages, as they have come to be called, but they have had limited results. In the most recent package, the first part of which was announced December 25, Japan granted unilateral tariff reductions on agricultural and industrial items including cigarettes and chocolate.

In the case of cigarettes, however, the Japanese Government has subsequently decided to impose a surcharge which will offset perhaps as much as 50 percent of the benefits of the tariff cuts. This decision was made despite several expressions of concern by U.S. Government officials and commitments by the Government of Japan to not allow the effect of the tariff reduction to be undercut.

The second stage of the package announced January 13 provided for a review of Japanese laws and regulations governing the certification of imports. The recommendations announced on March 26 addressed several key U.S. concerns. We have not yet seen the revised legislation, but we have emphasized that swift action by the diet and effective implementation will be needed.

The one proposal that has been explained to us in some detail stops far short of providing U.S. manufacturers with equal access. Japan rejected our request to allow U.S. automobile manufacturers to self-certify conformance with Japanese safety standards.

As you well know, Japanese auto manufacturers export to the United States 1.68 million cars each year based upon their self-certification. Japan refuses to allow U.S. car makers the same privilege for the few thousand U.S. manufactured cars which are exported annually to Japan. Thus, on balance our intense trade discussions with Japan have prompted some liberalization measures which have in turn appeared to solve some problems, but yet without providing any major market opening breakthrough.

My full statement explores a number of the remaining issues at some length. I would like to take this opportunity to focus attention on just two of these prospects for improved performance under the NTT [Nippon Telegraph & Telephone Public Corporation] agreement and the problems posed by Japanese targeting of U.S. high technology industries.

As a tool for increasing U.S. sales, the NTT agreement has been a disappointment despite the efforts of Dr. Shinto, the president of NTT and a number of other NTT executives. In the 2 years since the agreement, U.S. sales of telecommunications equipment to NTT have been approximately $17 million out of a total of over $6 billion in procurement by NTT.

At the same time Japanese companies in the aggregate have sold almost $6 billion of their equipment in U.S. markets. NTT has fulfilled the letter of the agreement and in some instances has exceeded their specific requirements.

The failure to generate sales reflects deeper-seated differences in Japanese and American ways of doing business, including the formulation of standards and the sharing of technology. Our concern with improving U.S. access to NTT is related to our larger interest in improving conditions for bilateral high technology trade.

The Commerce Department recently published a report which concludes that Japan represents the most serious threat to U.S. technological preeminence. Several factors, including financial market structure, and availability of skilled personnel contribute to Japan's increasing competitiveness in high technology.

Perhaps the most significant factor advancing the competitiveness of Japanese firms is the process of industry targeting. To support the development of target sectors, the Japanese Government adopts a variety of measures including financial, tax and R&D benefits for research and development. The Government also protects the domestic market from competitive imports. It provides export incentives and helps demand for high technology products through Japanese Government procurement practices.

The significance of this process far exceeds the actual funding involved for several reasons. No. 1, by designating the subject for research MITI eliminates a large element of risk and signals to Japanese financial institutions that participating companies are favored borrowers.

Second, this continuing assured flow of funding allows Japanese companies to build capacity very rapidly. Third, by combining several of the country's leading companies in a single project, redundancies are eliminated as are expensive false starts.

In the semiconductor industry, for example, the involvement of MITI in organizing the VLSI or varied large-scale integration project is estimated to have cut Japanese development costs far below what they would have otherwise been. Perhaps as much as $500 million in so-called loans was provided to Japanese companies in the competition for new markets in the field of semiconductors. To our knowledge, not one dime has yet been repaid to the Government in a program which officially terminated a number of years ago.

Lastly, by identifying the project as a national effort targeting signals a preference to buy Japanese by both the Government and private buyers. I recently visited Japan to observe how the process operates. I toured several of the country's major laboratories, the leading high technology companies, and I talked with both MITI and a number of other officials involved.

Perhaps what the Japanese are doing is not unfair in the traditional use of that word, but the process does raise several issues, among them the need to accelerate equivalent opportunities for American companies to trade and invest in Japan's high technology group, an opportunity which does not currently exist. We need to further examine the means by which the injurious effects of target industry practices can be effectively dealt with.

We need, further, to look at the ways in which military coproduction agreements with the United States hasten the success of Japanese commercial ventures, and we need also look at the potential impact on the Japanese information industry and markets worldwide resulting from the conversion of NTT to a private company. I expect that will take place over the next few years.

To deal with some of the issues specific to high technology trade with Japan, the Department of Commerce and the USTR have joined with MITI to form the United States-Japan Work Group on High Technology. The pursuit of these issues in that group is a priority U.S. trade policy concern. Again, that group is just a forum for discussion at this point.

Given the importance of these industries to our national economy, and I would underscore to our national security interests, the need for solutions is urgent.

Mr. Chairman, members, that is all I have to say on that score, but during the course of Mr. Sprinkel's elaboration on the relationship between the yen and the dollar, I could not help but reflect on the fact that over the course of time it has not made much difference in terms of our bilateral trade deficit. If I could without being an economist leave you a couple of statistics I think are pertinent, it might shed some light on a point I would like to make.

In 1977 there was an $8 billion deficit between us. The United States had a deficit relative to Japan, and the yen was 270 to the dollar. The deficit was about the same in 1979, 2 years later when the yen was 220 to the dollar, but when the yen was still 220 to the dollar, that is in 1981, the trade deficit doubled to almost $16 billion.

The yen-dollar question remains. Clearly, it is an important element, but it is not the only element, and we do need to keep pressing for access to their markets.

Thank you, sir.

[The prepared statement follows:]

STATEMENT OF LIONEL OLMER, UNDER SECRETARY FOR INTERNATIONAL TRADE, DEPARTMENT OF COMMERCE

Our economic relationship with Japan continues to be extremely important, yet filled with problems the solutions to which remain elusive. There have been several potentially significant developments in the past few months, but many of the underlying difficulties remain. Whether these developments prove useful must be determined by the actual experience of U.S. exporters. I will first address some recent results of our trade discussions with the Japanese government and then examine the more important issues in detail.

Recent Developments

In January, Prime Minister Nakasone visited the United States. The trade aspects of our bilateral relationship occupied a central place in his discussions with President Reagan and with Cabinet members. The new Prime Minister stressed his desire to resolve trade problems and committed himself to full implementation of the trade liberalization measures which had been announced January 13.

Secretary Shultz stopped in Japan during his January Far East trip and Ambassador Brock visited Tokyo in February. Secretary Baldrige will visit Tokyo next month. The high-level political dialogue with the new Japanese Government is well underway, and there seems to be a clear recognition by the Nakasone government of the urgency and scope of problems in the trade area.

There are several other developments which add a new perspective to our continuing talks with Japan.

Both governments have accepted the recommendations of the bilateral Work Group on High Technology Industries. We are now concentrating on speedy implementation of these recommendations. Our goal will be to reach agreement with the Japanese Government on appropriate remedies to offset or eliminate the trade distorting effects of Japanese industry policies on U.S. high technology industry.*

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* Attached is a copy of the basic agreement governing the conduct of this Work Group as well as the recommendations for its short and long term agenda.

In other developments, the Congress has approved a new Governing International Fisheries Agreement (GIFA) and talks are in progress for a renegotiation of the 1980 Fisheries Trade Agreement.

We are reviewing the present NTT agreement which will expire at the end of this year unless renewed and are discussing with the Japanese Government means to improve the prospects for significant U.S. sales to NTT.

Japan has agreed to extend its voluntary restraints on automobile shipments to the United States in JFY 1983 at the same level as this year.

Finally, U.S. experts have met with their Japanese counterparts to discuss the Japanese Government's undertaking to revise its standards and certification laws affecting imports.

The Japanese Study Group has issued its report to Prime Minister Nakasone on changes in this area, and proposed legislation is being drafted. The Japanese Government will submit legislation to the Diet this month.

At least some of these developments hold out the promise of resolving trade problems. I will explore these in more detail later in this testimony. But first I'd like to describe some aspects of our trade relationship with Japan that have not changed significantly.

Problems Remaining

Japan remains our second largest trading partner and we are Japan's largest market. Our bilateral trade imbalance reached $17 billion last year. This year we expect the deficit to rise to about $20-22 billion. The deficit in part reflects the continuing lack of access to the Japanese market for U.S. sales and investment.

Our bilateral high technology trade is similarly in deficit. In 1980, U.S. high technology exports to Japan were $4.9 billion; imports were $7.7 billion. Japan remains the only country where our high technology trade is in deficit.

Many of the basic Japanese policies which cause these problems remain in effect:

-- the Japanese Government continues to target industrial sectors and to nurture them with numerous incentives.

-- intragroup preferences are routinely granted to members of the keiretsu.

-- the formal approval of cartels and informal encouragement of industry consortia continues.

-- high tariffs and quotas remain on key U.S. exports despite liberalization "packages".

-- the complex distribution system acts as an impediment to foreign sales, often precluding foreign suppliers from direct access to end users. In addition, because of close intragroup ties, there is often an inherent disincentive to purchase foreign items competing directly with domestic products.

-- investment is impeded by the difficulty foreigners experience in trying to acquire Japanese companies.

-- to date, the Japanese Government has tried to manage trade frictions without addressing their underlying causes.

It is evident that the major accomplishment in resolving our bilateral trade friction so far consists in winning Japanese agreement to establish appropriate fora for discussion of the key problems. The next step is to utilize these -- the high technology group, Executive Council of the Trade Facilitation Committee, the Trade Subcommittee, the forest products group, the bilateral standards group -- to actually resolve the problems.

GOJ Trade Liberalization Measures

To achieve the proper perspective it is important to review GOJ efforts to resolve the problems. Over the past 14 months, Japan introduced a series of trade packages which it claimed would greatly increase access to its market. The first package was announced on January 30, 1982. It consisted of responses to complaints about specific Japanese trade practices received from various countries. Apart from some important progress in the area of customs procedures, the package contained virtually no new progress on issues of interest to the United States. The case-by-case approach of the package also ignored the need for broad-based actions to deal with the larger issues in our trade relations.

As a result of U.S. dissatisfaction with the first trade package, Japan announced a second package on May 28. This package identified many of our major trade problems and offered general assurances of remedial action. The package was very short on specifics, and the Administration took the position that its value depended on the degree to which its general intentions were implemented. To monitor implementation, U.S. delegations visited Japan four times between August and December for a review of progress in turning statements of good intentions into tangible actions. These talks did not yield much evidence of action by Japan to implement the measures in the package.

On December 25, Japan announced unilateral tariff reductions on agricultural and industrial items, some of which had been requested by the U.S. The most significant of these were the reductions on tariff rates for cigarettes and for chocolate. In the case of cigarettes, however, the Japanese Government subsequently decided to impose a surcharge which will offset some of the benefits of the tariff cuts. This decision was made despite several expressions of concern by U.S. officials and a promise by the Prime Minister that he would not allow the effect of the tariff reduction to be undercut.

These tariff cuts were followed on January 13 by a new trade package. The cornerstone of this latest package is a commitment by Japan to review its laws and regulations governing the certification of imported goods, and to recommend changes aimed at providing foreigners with equal access to certification systems. Such a revision has been a major U.S. trade policy objective.

Japan is moving quickly to follow up on this commitment. A group was formed under the direction of the Chief Cabinet Secretary and made its recommendations on changes in Japanese laws and regulations on March 26. The group met with U.S. standards experts to learn about comparable U.S. practices.

The recommendations announced by Japan on March 26 address key U.S. concerns with regard to the principles of non-discrimination, direct access, transparency, acceptance of foreign test data, harmonization with international standards, and simplification of procedures. We have not yet seen the revised legislation but we have emphasized that swift Diet action, and effective implementation will needed.

The one proposal that has been explained to us in detail stops short of providing U.S. manufacturers with equal access. Japan rejected our request to allow U.S. automobile manufacturers to self-certify conformance with Japanese safety standards. Japanese auto manufacturers sell 1.68 million cars in the U.S. each year based on their self-certification to U.S. safety standards. But Japan refuses to allow U.S. car makers the same privilege, and has instead proposed a type designation system that would continue to require inspection of each individual vehicle before it could be sold in Japan.

The remaining provisions of the most recent trade package are not as far-reaching. The Office of Trade Ombudsman (OTO) has been strengthened through the addition of a high-level advisory committee. But OTO has not been granted the authority to resolve trade complaints. Its role is still limited to that of a "messenger" agency -- it simply passes complaints to other ministries, and reports their responses back to the complainants. Without the ability to resolve complaints on its own, OTO's value remains limited.

Japan promised also to speed up the pace at which it will allow retail outlets to carry foreign tobacco products. It has pledged to try to open all tobacco retail outlets to foreign products by March 1985, one year ahead of the schedule announced last May. Despite this acceleration, I remain perplexed as to why Japan does not simply allow all retail outlets to carry imported tobacco products immediately.

On balance, our intense trade discussions with Japan and the resulting liberalization measures have solved some of our minor problems and recently have addressed more major difficulties in at least a potentially significant way. As yet no major market opening breakthrough has occurred, although I believe the problems are certainly much better defined.

NTT

One of the more complex aspects of our market-opening efforts has been the implementation of the NTT agreement.

The agreement has not worked very well to date as a tool for increasing U.S. sales to NTT. Some of the reasons for this are the anti-foreign product bias of many middle level NTT procurement and engineering personnel despite the efforts of Dr. Shinto, the President of NTT, and other NTT executives to eliminate it. In addition, some U.S. company efforts have been incomplete.

Let me describe some specific developments under the current agreement.

In December 1980, after intensive negotiations, the bilateral agreement was signed between the United States and Japan opening NTT procurement to foreign manufacturers. This agreement in theory gave U.S. exporters access to NTT equal to the access that Japanese electronic companies have to the U.S. telecommunications market. In the two-year period following the agreement, however, U.S. sales of telecommunications equipment to NTT have been approximately $17 million out of a total of over $6 billion in procurement by NTT, while Japanese companies have sold $5.5 billion of their equipment to the United States.

In 1981, only eight American companies won contracts with NTT out of a total of 91 tenders for which bids were sought. These contracts were valued at about $3.4 million and were primarily for equipment at the low end of technology.

In 1982, an estimated $13 million in U.S. contracts were awarded, also at the low end. No procurement from U.S. sources has yet been made under Track II and Track III, but NTT expects to sign a contract with a U.S. firm this month for the purchase of $3.3 million of satellite echo canceller terminals. Under Track IIA, a contract has been signed with Motorola for the purchase of about $9.3 million of pocket bell-pagers. AMP Inc. has made a successful tender for CCP cable connectors and Plantronics for lightweight headsets. In December 1982, Paradyne Japan Corporation, a wholly-owned subsidiary of Paradyne Corporation of Largo, Florida, was the lowest bidder for a high speed 9600 BPS modem. In March a contract for about $5 million was awarded to ITT for private digital telephone switches.

Prolonged delays are a constant problem for U.S. manufacturers seeking official approval of their products. One U.S. firm struggled for the better part of a decade to get approval from NTT for headphones used in combination with Japanese telephone system equipment. Sometimes this delay is used by Japanese firms to develop a competitive product, which then rapidly dominates the market.

The fact that NTT often specifies to the smallest detail the design characteristics of a product, rather than judging a product on the basis of its overall performance, biases the entire approval process and is a major disincentive to U.S. firms.

Research and development programs of NTT primarily involve joint R&D by Japanese corporations to develop the products to be purchased. R&D is thus a closed loop, reinforcing import restrictive effects by restricting foreign firms' access to both Japanese markets and Japanese technology.

These problems and practices bring the effectiveness of the agreement into question. NTT has fulfilled the letter of the agreement, and in instances has exceeded its specific requirements. The failure to generate sales reflects deeper-seated differences in Japanese and American ways of doing business, including standards formulation, and sharing of technology, among others.

Competitive Conditions in U.S.-Japan High Technology Trade

The Commerce Department has just published a report which assesses U.S. competitiveness in high technology industries, although the conclusions of this report do not reflect Administration consensus. I would like to include with my statement the executive summary of this report which concludes that Japan presents the most serious threat to our technological preeminence. That threat will intensify as Japan continues to concentrate resources on developing knowledge-intensive industries -- a course already charted by MITI's "Vision of Industrial Policy for the 1980s".

Several major factors contribute to Japan's increasing competitiveness in high technology industries:

- Japan's financial markets and government policies foster cheaper and more abundant capital than available in the U.S. Captial cost differentials affect competitiveness because they are eventually reflected in price. Japan's financial markets are organized to provide plentiful low-cost capital to selected industries. Japan's tax policies also give high tech firms an edge on competitiveness by allowing for special reserves and special accumulated depreciation for spending on research and development equipment.

- Japan's funding of R&D has grown more rapidly than ours. During the 1970's, the growth rate of R&D expenditure by Japanese firms was 50 percent greater than that of U.S. companies. At the same time, the Japanese government was also rapidly increasing funds for R&D, and, while U.S. government R&D expenditures are defense related, Japan's are generally earmarked for commercial application.

- Probably the most significant factor advancing the competitiveness of Japanese firms is the Japanese Government's industrial policy. The key to this policy is industry targetting -- a process which identifies sectors that have the best prospects for technological advance and international competitiveness. To support development of these sectors, the government adopts a variety of measures, including the financial, tax, and R&D benefits already described. The government also protects the domestic market from competitive imports, provides export incentives and helps build a demand cycle for high tech products through government procurement programs. Finally, close government and industry collaboration ensures synchronized activity aimed at predetermined objectives. Overall, Japanese government-industry cooperation gives Japanese firms a significant competitive edge over their U.S. counterparts that must compete without direct government assistance.

The high technology industries that are included in Japan's targetting programs are vital to the political and economic security of both the U.S. and Japan. They contribute to economic growth, to export earnings, and to defense capabilities. Given their importance, bilateral trade frictions could easily develop in this area. To defuse these and to focus on issues specific to our high technology trade with Japan, the Department of Commerce and the USTR joined with MITI to form the U.S.-Japan Work Group on High Technology Industries. We are using this Group to broaden U.S. firms' access to Japan's market for high technology goods and services, to create a more equitable balance in technology flows, and to try to ensure that Japanese competitive practices in our market conform to international rules and obligations. The Group will study on a priority basis Japanese industrial practices and their possible trade distorting effects.

Earlier this year the U.S. and Japanese cabinets endorsed several recommendations that the Group submitted to the respective governments after its first round of meetings. The recommendations commit both governments to minimize trade distortions associated with government actions; to ensure full foreign access to trade and investment opportunities; and to open government-sponsored R&D (excluding those dealing with national security) and other industry promotion programs to foreign firms.

The Japanese Government has agreed to develop measures to promote imports of U.S. high technology goods, and both sides will jointly develop a data-base to track bookings and billings of U.S. and Japanese semiconductor firms. Included in the recommendations is a long-term work program that calls for analysis of trade issues in semiconductors, computers and telecommunications.

The Work Group met two weeks ago to begin implementation of these recommendations. In this meeting, we accomplished the following objectives:

- We worked out the details of the semiconductor reporting system which will begin on May 1. This will help us to identify--and resolve--trade problems as they arise;

- We agreed on the outline for a semiconductor sectoral study which is now in progress. Our objective for the study is to identify trade distorting effects of Japanese Government programs which support the semiconductor industry. Based on this study, the group will develop recommendations to restore free trade and competition in this sector. The recommendations will be submitted for the approval of the two governments in October.

- We formed a task force, chaired by Gerald Mossinghoff, Commissioner for Patents & Trademarks, to facilitate U.S. firms' access to Japanese patent information.

- Finally, we also established a mechanism to ensure a more balanced flow of technical data between U.S. and Japanese government organizations.

Japanese Industrial Policy

It is clear that the center of the trade policy debate has shifted in the direction of industry policy - and its effects on trade flows.

Japanese industrial policy addresses two fundamental economic issues:

- it provides for the orderly decline of the so-called "mature" industries; and

- it organizes a national strategy for early achievement of dominance in emerging industries.

Although the specific issues vary from one industry to another, and within one industry over time, there are common themes in the Japanese approach to industry policy. These are:

- the extraordinary degree of consultation between Japanese industry and the Japanese Government;

- the emphasis on building capacity which is often unrelated to demand expectations; and

- finally, a tradition of collaboration and consensus.

In declining industries, the descent may be made more graceful through the constant attentions of MITI during the middle or transitional years. Industry Structure Councils in the major MITI industry bureaus focus the discussion of an industry's condition and develop a habit of consultation and cooperation which may start when the industry faces cyclical problems and is granted permission to form a recession cartel or when there is dawning recognition that changing resource prices (as in the petrochemical industry) or competitive patterns (as with shipbuilding) have rendered the industry permanently depressed.

At this point, a rationalization plan may be developed within MITI by the Industry Structure Council. This will specify aggregate and individual levels of production to be retained, and provide an agreed, orderly plan for phasing out the redundant productive capacity and workers. All of this is possible through the cooperation of the banking system and by the explicit or implicit exemption from antitrust laws. (The Japanese banking system is reported to have sustained the declining aluminum industry with credits exceeding $5 billion, or several times assets and, ultimately, at government request, to have absorbed most of this as a loss).

Most frequently in declining industries the problem for us is the inclusion in the government relief program of measures designed to protect the industry from disruptive -- meaning competitive -- imports. This ensures that the remaining domestic capacity can be fully utilized serving the domestic market. Imports remain below the levels they would reach if market access were free.

The Department of Commerce has had some experience in dealing with the trade implications of depressed industry policy, primarily through the work of our TFC Executive Council. In the context of this Council, which I chair for the U.S. side, we have considered the trade effects of industrial policy. One of our first cases was the Japanese soda ash industry, which cannot compete with U.S. producers because of the relatively high price of its petrochemical raw materials. We identified a domestic cartel in the industry which owned the only unloading facility in Japan and which limited U.S. imports to a small -- and static -- share of the Japanese market. As a result of our initiative, the Japan Fair Trade Commission has determined that the Japanese companies violated the anti-monopoly law and has secured their agreement to end these illegal practices.

We have also submitted to MITI a study of the paper industry -- another of Japan's structurally depressed industries. With the support of the U.S. industry, we focused the U.S. case primarily on a request for tariff reductions -- which have in some small measure been granted. We plan now to explore other issues in this sector, including an industry association -- which we would characterize as a soft cartel -- and which we believe acts to limit imports from the U.S. And the Administration will press for additional tariff cuts.

We have also been consulting extensively with the Japanese on the renewal of Depressed Industry legislation, which expires this June. The purpose of the legislation is to provide a legal framework within which industries recognized as structurally depressed--that, is, in long-term, terminal decline--can be exempted from Japan's anti-monopoly laws to facilitate implementation of plans to reduce capacity and to share declining markets. Our concern is occassioned by the fact that such plans frequently include some provision--explicit or implicit--for limiting or managing imports as well.

I am somewhat encouraged that our demonstration of interest in this area may have had some result. According to reports from Tokyo, the version of the bill which will be introduced in the Diet does not provide for the kind of blanket anti-monopoly exemption which MITI had been seeking. MITI will be required in each instance to seek specific authority--and provide specific justification--for any such exemptions from the Japan Fair Trade Commission.

At the same time, the new bill reportedly will provide for specific government assistance -- such as subsidized R&D -- to restore competitiveness to these industries. We will have to see if implementation of any of these provisions threatens to violate U.S. trade laws or international trade agreements.

We have proposed discussing these issues with Japan at our upcoming meeting of the Executive Council of the Trade Facilitation Committee in Tokyo on May 18. We hope to obtain further information on the bill at that time, and to express our concerns regarding any provisions which may foster anti-competitive behavior.

In the emerging high technology industries, the issues are somewhat different, but the basic policy process is the same.

This may start when the technology is only a concept. For example, MITI's Agency for International Science and Technology provides a focus for government and industry discussion about next generation technology, so that it is difficult to say with any precision where the initial impetus originates.

MITI does play a specific, and important role in "defining the fairway", that is, in indicating the broad areas of technology which will be emphasized -- or targetted -- in future government development efforts. Interestingly, MITI often looks to the leading U.S. institutions -- Bell Labs, IBM, and other leaders in the field -- to point the way.

Assuming that MITI is convinced that the technology merits further exploration, MITI may directly fund the research to a consortium of firms, it may contract out the research, it may decide to conduct investigations in its own research lab, or it may seek partners for collaborative research with the MITI labs. In most instances, the first option is pursued, and a research association is formed to conduct the research, with the agreement that MITI funds will only be repaid if -- and when -- the project is profitable.

The significance of this process far exceeds the actual investment by MITI, for several reasons:

-- by designating the subject for research, MITI eliminates a large element of risk and signals to Japanese financial institutions that participating companies are favored borrowers;

- this continuing, assured flow of funds allows Japanese companies to build capacity rapidly and to generate surpluses for export;

- by combining several of the country's leading companies in a single project, MITI eliminates redundancies and expensive false starts. In the semiconductor industry, for example, the involvement of MITI in organizing the VLSI project is estimated to have cut Japanese developmental costs far below comparable spending by U.S. industry; estimates vary, but as much as $500 million was provided to Japanese companies in the competition for new markets in the field of semiconductors. Not one dime has yet been repaid to the government.

- by identifying the project as a national effort, targetting signals a preference to "buy Japanese" by government and private buyers. Frequently, as we have demonstrated with certain microelectronic devices, the U.S. will be completely shut out of the market once Japanese production begins. Or, as in the case of supercomputers, it may be impossible to sell even while the Japanese product is being developed.

I recently visited Japan to observe first hand how this process operates. I toured several of the country's major labs, the leading high technology companies, and I talked with MITI and other officials involved. Perhaps what the Japanese are doing is not "unfair" in the traditional use of the word. But I definitely concluded that this process raises several issues: the need for measures to accelerate equivalent opportunities for American companies to trade and invest in Japan's high technology growth; means by which the injurious effects of target industry practices can be effectively dealt with; the ways in which military co-production arrangements with the U.S. hasten the success of Japanese commercial endeavors; and the potential impact on the Japanese information industry and markets worldwide resulting from the conversion of NTT to a profit-oriented company.

Yen/Dollar Relationship

The Commerce Department testified before this subcommittee last November 30 in detail on this issue and presented our findings regarding the effects of this relationship on our bilateral trade flows.

Before summarizing these conclusions, which still remain valid, I should note that the yen has appreciated over the past several months. This is a welcome development.

We have found no evidence that the Japanese Government has intervened to maintain an artificially depressed yen as a stimulus to export sales. In fact, there is some evidence that the Bank of Japan did intervene to support the yen. Both the Caterpillar and Ford studies of the issue confirm this, although pointing out that it was ineffective. This is not to say that the yen has not been undervalued. I believe it has, as have many other currencies vis-a-vis the dollar.

But there is another aspect of Japanese policy which contributes to the problem. The fact that investment in Japan is unnecessarily difficult and that the Japanese market itself is closed creates a chronic, artificially low demand for the yen. It exacerbates the already strong institutional preference for holding certain currencies such as the dollar.

In general, the effect of yen depreciation is greater on U.S. imports from Japan than on U.S. exports to Japan. It also has a significant adverse effect on the competitiveness of U.S. exporters vis-a-vis their Japanese competition in third markets. This, combined with the loss of competitiveness against other developed country exporters, is a major contributing factor to our global trade deficit.

Exchange rate variations may have some effects on our bilateral trade deficit, but these are relatively unimportant over the long run when compared to the structural causes of this chronic trade imbalance. After all, we've had a trade imbalance when the yen was 180 per dollar (as in 1978 with a bilateral deficit of $11.6 billion) as well as when it was 250 per dollar (as in 1982 with a deficit of $17 billion).

Here we return to the fundamental problem of Japanese barriers to the sales of U.S. products; of Japanese policies which artificially stimulate Japanese exports; and of the low propensity of Japan to import finished manufactured products.

In our view, the chronic trade imbalance is best addressed by dealing with these problems. This includes removing Japanese barriers to free financial flows and to full internationalization of the yen.

All countries must be aware of the effects of macroeconomic policies on exchange values and on trade flows. Perhaps some changes are needed in existing international financial adjustment mechanisms. These are questions to be dealt with multilaterally. Our trade problem with Japan is the result of Japanese trade and industrial policies, and our efforts should focus on these.

Wang No. 2133N

SUMMARY

In December of 1981, the Cabinet Council on Commerce and Trade (CCCT) directed that a study be performed on the current competitive posture of the United States in high technology. The assessment was performed by the Department of Commerce. This study is being released as a Department of Commerce document. The methodology, findings, and conclusions do not necessarily represent the views of other Executive Branch agencies.

Concern with U.S. performance in high technology sprang from the recognition that the gains to the United States from advanced technology are quite significant.

The United States occupies a unique leadership position in the world political and economic structure—a leadership role underwritten by its preeminence in advanced technology. The possible erosion of this preeminence could have far-reaching economic, political, and national security consequences for the United States.

The special combination of contributions to the U.S. economy of high technology industries—including high productivity growth and low price growth—indicate the importance of this segment to the overall strength of the U.S. industrial base. There is a direct linkage between the research activities conducted by high technology industries and the U.S. standard of living. Research nurtures innovation, which feeds technological progress, which leads to productivity gains. Productivity over the long run is the predominate element which determines the overall ability of the U.S. economy to grow and in turn to produce a higher standard of living and new jobs.

As the high technology industries of other countries have emerged as strong international competitors, U.S. high technology industries are facing a significantly altered competitive environment. In the new environment, the United States faces a major challenge to maintain its broad technological preeminence.

This report examines U.S. high technology industries—their importance, their trade performance, and the factors influencing their competitiveness vis-a-vis foreign competitors. Key findings include the following:

- High technology industries are vital to the U.S. economy. Their growth rate has been twice that of total industrial output, and they contribute the bulk of technological advances to all sectors of the economy.
- National security depends upon the technology-intensive industries both for sophisticated items essential to modern weapons superiority, and for a strong and flexible industrial capability for future contingencies.
- The United States will have to depend heavily on its areas of greatest strength—principally advanced technology—to meet increased competition in world markets. The technological challenge confronting the United States can benefit all competitors and nations through increased efficiency and growth.
- Over the last twelve years, there has been a decline in the international market position of U.S. high technology industries from a position of dominance to one of being strongly challenged. *Market share* for the high technology group—and for nearly all individual industries—*has fallen*. Foreign competition in high technology has increased dramatically, with developments in selected new areas indicating that technological advantages have shifted overseas.
- An array of factors influence U.S. versus foreign advances in technology. The most important of these across all industries are:

  —the overall state of the domestic economy,

  —cost and supply of capital,

  —relative R&D efforts,

  —the transfer of technology,

  —availability of scientists and technicians, and

  —explicit foreign industrial policies targeting the technology-intensive sectors for development.

- If present trends continue, some or all of these factors could contribute to a further decline in the competitive position of U.S. high technology industries.
- Foreign government industrial programs to promote high technology industries have adversely affected U.S. high technology industries and will, if trends continue, place U.S. business at a disadvantage, even with an ideal environment for high technology within the United States. Industry targeting by foreign governments against specific high technology areas could preclude valuable long term U.S. technological developments.
- The major technological challenge to the United States is from Japan. Now limited to a few high technology sectors, this challenge can be expected to broaden in the future.

Recommendations of the U.S.-Japan Work Group On High Technology Industries

FOREWORD

In the area of high technology industries, industrial structures and trade patterns have been rapidly changing in the course of active technological innovations and development of new products both in the U.S. and Japan. These conditions may increase the potential for disruption in high technology markets and heighten frictions among trading partners. To resolve current problems, promote understanding and improve prospects for growth in high technology industries, the Work Group has begun by examining pressing issues in bilateral high technology trade, especially in the areas of semiconductors, supercomputers, and fiber optics.

Based on its discussions, and in accordance with its terms of reference, the Group submits the following recommendations to the appropriate authorities of both governments. Nothing in these recommendations shall be construed as limiting or derogating from the international legal rights and obligations of the two countries.

Activities of the Work Group naturally concern industrial and trade matters pertaining to the field of high technology. Nothing contained in the recommendations is intended to prevent either country from taking any action or not disclosing any information which it considers necessary for national defense purposes.

The Work Group recommends that the recommendations contained herein be implemented insofar as is consistent with domestic laws and international legal obligations.

I. PRINCIPLES

The Work Group recommends that each government:

A. Goals and Means

-- Recognize that high technology industries have been growing rapidly and that further expansion of these industries has the potential to open up economic frontiers, assist in the revitalization of the world economy and contribute to the elevation of the quality of life;

-- Recognize the important role of government in improving the climate for private sector investment and research and also recognize its responsibility to minimize trade distortions and impediments to free and open trade, investment, and technology flows that may result from government actions related to domestic high technology industries; and

-- Reaffirm the importance of the role of governments in vigorously safeguarding the rules of the marketplace and preventing anti-competitive or predatory practices.

B. Free Flow of Trade, Investment and Technology

-- Undertake to ensure full mutual access to trade and investment opportunities in high technology industries;

-- Work for the reduction and elimination of such impediments and distortions as may exist in high technology trade;

-- Seek to ensure that opportunities to participate in each other's markets will be substantially equivalent. (With positive action on the part of the private sector and government, increased opportunities can be expected to lead to increasing participation in each other's markets which should be possible to assess);

-- Undertake to ensure that policies do not directly or indirectly discourage or impede government or private procurement of foreign high technology products or services, or bilateral transfers of technology;

-- With a view to promoting free, fair, and open competition in high technology, undertake to provide that programs which provide particular advantages to enterprises in specific high technology industries will be open to enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

C. International Cooperation

-- Affirm the significance of exploring appropriate ways in which cooperative efforts, including cooperative R&D and technology exchange consistent with anti-trust laws and policies, could promote high technology industries;

-- Undertake to ensure that participation in government sponsored R&D projects will be open, in principle, to enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

III. IMPLEMENTATION

A. Market Access and Trade Promotion

1. Joint Data Collection

The Work Group recommends that for a full assessment of the factors affecting bilateral high technology trade, the Work Group establish with the cooperation of private sector sources in both countries, a Joint High Technology Data Collection Task Force. The Task Force would begin with semiconductor data collection in the following manner:

-- Decide on the coverage, classification and methods of data collection, taking into account the usefulness and availability of the data.

-- Gather data on bookings and billings for the U.S. and Japanese markets.

-- Gather additional useful production and trade data.

-- Develop methods for eliminating statistical distortions such as those resulting from different treatment of value added in countries other than the United States and Japan.

These activities should be conducted in a manner consistent with each side's anti-trust or anti-monopoly laws and policies. The Task Force will begin collection of data, including bookings and billings, as of March 1, 1983 and make its first report to the Work Group on the data collected in early April, 1983. The Task Force will report on its progress at each meeting of the Work Group. Under the guidance of the Work Group, the Task Force will consider similar data collection in other high technology sectors.

2. Solving Trade Problems

The Work Group recommends that:

-- Problems of access, if any, especially as they relate to procurement and distribution, be discussed and solutions sought in the Work Group. If both sides agree, the Work Group will, as appropriate, take steps to have relevant agencies or independent organizations investigate and solve the problem. Note: Each side is, of course, free to take independent action.

- Each government include enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country in its programs, and encourage inclusion of such enterprises in private programs, to promote sales or provide other economic benefits in the field of high technology industries.

- Each government take steps to eliminate the use of such specifications as may exist which arbitrarily discriminate against enterprises owned or controlled, directly or indirectly, by nationals of the other country in the procurement of high technology products by government entities and encourage the elimination of such specifications by private sector organizations. Any technical specifications prescribed by government procurement entities should, where appropriate, be in terms of performance rather than design. Taking into account the views and activities of the Work Group, among others, each government should explore issues related to the appropriateness of technical specifications prescribed by government entities.

- The Government of Japan develop possible concrete measures to promote imports of manufactured goods in high technology in light of the Prime Minister's May 28 statement, taking into account the views and activities of the Work Group.

B. Information Exchange, Technology Transfer and International Cooperation

The Work Group recommends that:

1. Channel for R&D Information

The governments create a government-to-government channel to facilitate the timely exchange of information on upcoming government sponsored R&D projects, and to provide information on ongoing projects including methods of access and technology rights.

2. Information Windows for Patents/Technology

Each government establish information windows to answer private sector inquiries concerning patent and technology exchange, including, where practicable, catalogue of patents, procedures for gaining access to patents, and procedures for licensing technology.

3. Data Exchange

Each government establish measures and institute proceedings to ensure a balanced mutual flow of technical information through appropriate public and private organizations, and make available technical reports on current government sponsored programs at least annually.

4. Access to Programs

Each government ensure that government sponsored R&D programs will be open, in principle, for participation by enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as for enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

5. International Cooperation in R&D

Each government make further efforts to promote cooperation in R&D in the technology fields which are suitable for international cooperation.

6. Access to Technology

Each government undertake to facilitate licensing of patents and technology held by the government in blocks and families rather than item by item, to enterprises owned or controlled, directly or indirectly, by nationals of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.) Each government also undertake to limit government intervention in the licensing of privately held technology.

7. Investment

Each government undertake to ensure that plans calling for the development or rationalization of a high technology industry are drawn so that all enterprises constituted under the laws and regulations of the one country, and owned or controlled, directly or indirectly, by nationals or companies of the one country or of the other country participating in such an industry, are treated equally in terms of the opportunity for inclusion. Each government also undertake to ensure that enterprises constituted under the laws and regulations of the one country, and owned or controlled, directly or indirectly, by nationals or companies of the other country, are treated on the same basis as enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country in access to investment promotion programs, including depressed area funds, concessionary lending, etc.

8. Facilitating Cooperative R&D

The U.S. government review the impact of U.S. antitrust law on the ability of U.S. enterprises to participate in cooperative R&D programs, and make appropriate recommendations.

C. Competitive Practices

1. Accounting Analysis

The Work Group recommends that by the end of March 1983, it bring together financial staff from high technology firms to examine U.S. and Japanese accounting methods in high technology industries.

IV. GENERAL

The Work Group will:

1. Report on Market Development and Trade

Using the joint data collection developed under Section III A.1. above, issue regular reports on market trends for high technology products in the U.S. and Japan and technology flows between the two countries.

2. Invite Private Sector Participation

Invite private sector advisors and industry representatives to participate in subcommittees of the Work Group, particularly in the consideration and development of individual sector reports, and in the review of trade distortions and conditions in specific high technology markets.

V. LONG TERM WORK PROGRAM

The Work Group will undertake a long term work program, according to the attached outline.

VI. ADOPTION

The Work Group recommends that the two governments act on these recommendations, after necessary internal procedures, not later than the end of January 1983.

OUTLINE FOR LONG TERM WORK PROGRAM

A. Sectoral Analysis

If agreed by both sides in the Work Group, the Work Group will conduct sectoral analyses with the objective of identifying and resolving sources of trade friction and of promoting industrial cooperation between the two countries.

The first sectoral analysis, a study of the semiconductor industry, will be initiated as of February 1, 1983.

Other sectors to be analyzed will be decided by agreement of both sides in the Work Group. Once a sectoral analysis has been agreed upon, the Work Group will agree on a timetable appropriate to the sector.

Upon completion of a sectoral analysis, it will be reviewed by the Work Group for not more than thirty days. The Work Group will then develop joint recommendations for resolving problems in the sector by its next meeting.

B. Research Associations and Organizations

The Work Group will undertake a joint case study of the organization, management, and decision-making process (including the handling of patent/technology, the decision to launch new projects, etc.) in a specific research association or organization.

C. Industrial Cooperation in High Technology

The Work Group will examine the nature of industrial cooperation agreements between the U.S. and Japan and between the U.S. and third countries and between Japan and third countries.

D. Other Issues

Other issues, including patent rights and import promotion measures, will be addressed at the agreement of the two sides in the Work Group.

Chairman GIBBONS. A very fine statement, Mr. Olmer. Thank you.

Mr. Lyng.

STATEMENT OF HON. RICHARD E. LYNG, DEPUTY SECRETARY, DEPARTMENT OF AGRICULTURE

Mr. LYNG. Thank you, Mr. Chairman, and members of the committee. I appreciate the opportunity to discuss our agricultural trade relations with Japan, a most important customer for American agriculture as well as a sturdy ally in this Nation's foreign affairs.

Japan is our largest single agricultural export market for farm products. In 1982, exports to Japan totaled $5.5 billion, about 15 percent of total exports of $36.6 billion. Japan is our top market for a number of agricultural commodities including feedgrains, soybeans, cotton, leaf tobacco, hides and skins, beef and fresh citrus.

Over the past years, Japan has been a steady and dependable market for our products, and we appreciate that. Our trade has helped reduce food prices for consumers in Japan, and it has contributed to farm income and created jobs on and off the farm here at home.

We value this trade highly and plan to remain the most dependable supplier of food, feed, and natural fiber to Japan and the rest of the world as well. As we look ahead into this decade, we would like to broaden our agricultural trade relationship with Japan to include more exports of high value products.

Up until now, Japan has been a market primarily for raw commodities such as grains, soybeans, cotton, and leaf tobacco. We anticipate that these items will continue to be the big-ticket items in our trade relationship. However, we would like to reach agreement with Japan on expanding the trade in beef and citrus when our current agreement, which was negotiated at the close of the multilateral trade negotiations, expires March 31, 1984.

The trade in beef, oranges, and citrus juice is important to us. Exports of these products to Japan in 1982 totaled $378 million. We have good reason to believe, however, that the Japanese market holds even greater potential for our oranges and high quality beef.

Last October we began talks with the Government of Japan about the future of our beef and citrus trade. At those talks in Honolulu, both sides had the opportunity to stake out their opening positions. We were successful in impressing the Japanese with the seriousness of our concerns about import quotas and high tariffs on beef and citrus. Since then, the subject of beef and citrus trade has demanded the attention of top policymakers in Japan and the United States.

We are now awaiting a serious trade expansion proposal from the Japanese that will enable us to resume these talks. Next week the first of these continuing talks is scheduled. We have stated that Japan should eliminate its restrictions on imports of beef and citrus. We sincerely believe that some barriers could be eliminated with them when the multilateral trade negotiation agreements expire next year, but we recognize that the removal of other barriers may require more time.

Time has about run out on our trade dispute with Japan on leather. Because of Japan's refusal to consider any fundamental changes, now or in the future, to the complex system of protectionist barriers surrounding the Japanese tanning industry, we have been seeking resolution of this issue in the GATT. None has been achieved, and yesterday I understand they announced that we will take the leather industry issue to the GATT.

In addition to beef, citrus, and leather, there remain other trade issues outstanding on our agenda for the 1980's. These include quotas on a number of other agricultural products, high tariffs such as those on lumber and forest products, and exclusive standards and narrowly drawn food health and quarantine laws which prohibit the sale of numerous processed foods and fresh fruits and vegetables in Japan.

In Government-to-Government talks to date, we have convinced the Japanese Government to take certain remedial measures to shore up the foundation of the free trade system, which has been endangered by erosion from a protectionist onslaught in recent years. These include reduction of duties on cigarettes, chocolate confections, cookies, numerous horticultural products, vegetable oils, and animal fats.

Many of these reductions were negotiated in the multilateral trade negotiations to be fully implemented by 1987. By advancing the date of implementation, Japan has demonstrated good faith in its efforts to address complaints about the closed nature of the Japanese market to value-added and consumer-ready goods.

The Japanese Government also clarified quota levels for a number of agricultural products including peanuts, dry beans, peas, noncitrus juices, fruit purees and paste, and tomato sauce and ketchup. While this will be helpful, we are disappointed that the Government of Japan did not undertake a more fundamental relaxation of the quota system.

Finally, in March the Japanese Government announced the completion of a review of standards and certification systems with an eye to bringing Japanese law into greater harmony with international standards. This is encouraging since the thicket of health, labeling, quarantine, and standards regulations very often ensnares our processed food at ports of entry.

The most welcome developments for agriculture are first, the promise to take steps to approve new food additives; second, the adoption of a new standard on plywood; and third, the general promise to improve transparency in drafting regulations, to increasing the use of foreign test data and international standards, and to simplify import clearance procedures.

I would be less than candid, however, if I did not say that the Government of Japan's perception of how to deal with our trade problems has not generally coincided with ours. Whereas we have proposed quick, direct action to alleviate discrimination against imported products, Japan has frequently denied that such discrimination exists, then underestimated its severity, then overestimated the negative side effects of corrective action, and then applied only as much relief as would make Japan comparable with other leading importing countries.

After all this is said and done, the opportunity for Japan to join us in leadership in support of free trade has been squandered, but at the same time the Japanese media have cast Japan in the role of caving in to U.S. demands. Our close partnership has been made to appear to be an adversary relationship.

The Government of Japan's approach can be explained partly by the intense opposition to trade expansion by Japan's farm and agribusiness establishment. Thousands of Japanese farmers have marched by our Embassy in Tokyo protesting any further growth in beef and citrus imports. A postcard campaign which recently swamped our Embassy with protest notes would be the envy of any U.S. mail campaign specialist.

I have with me this morning, Mr. Chairman, a poster which perhaps you saw when you were in Japan. The translation of that at the top says: "Guard against the liberalization and expansion of import quotas. Let's protect Japanese agriculture, forestry, and fishery." You will note that it is Superman U.S.A. descending upon the tiny island of Japan. Trailing behind is U.S. beef, citrus, and rice. This was sponsored and put out by the Central Union of Agricultural Cooperatives in Japan.

Under this intense pressure, 85 percent of the parliamentary members of the ruling Liberal Democratic Party have signed a statement opposing liberalization of beef and citrus imports and any expansion of quotas. Japan's other political parties also generally line up behind the farm lobby.

Taking the lead on agricultural trade expansion is, therefore, a risky business for the Japanese politician. The temptation to use the excuse of pressure from the United States is overwhelming when action for Japan's own good, but in opposition to the wishes of Japan's farmers, is required. Consequently, we are trying our best to be understanding, but our patience is being severely tested.

We intend to pursue our agenda for the 1980's by demonstrating to Japan's leaders and [illegible] agricultural community that expanded agricultural trade is in the best economic interests of both Japanese and Americans. Already many Japanese, especially in the industrial and business communities are coming to that view. Consumers are likewise becoming [illegible] of the benefits of increased imports in lower food prices and greater selection of products.

We intend to convince [illegible] Japanese farmer that increased imports will not destroy [illegible] her livelihood. Alternatives to import quotas, which currently infringe on our trading rights, can be adopted to maintain income and price supports for Japanese farmers.

We do not intend, however, to lecture Japan on the correct approach to adjusting domestic agricultural production to the realities of the market place. We intend to assure the Japanese Government and people that increased imports will not endanger Japan's food security. Food security is an important element in the agricultural policy of every country, but it is not necessarily achieved by protectionism which encourages the misallocation of productive resources and rewards inefficiency on the farm.

Finally, we intend to impress upon Japan's lawmakers that when they are drafting laws to shape the future of Japanese agriculture, they should remain mindful of the trade implications and Japan's GATT obligations.

In conclusion, Mr. Chairman, I would like to repeat that the agricultural trading relationship with Japan over the years has been of tremendous value to American farmers and agri-business. This relationship is not going to be soured by any outstanding trade issues. These will be resolved in a fair and just way. We are always willing to sit down with our counterparts in the Japanese Ministry of Agriculture, Forestry and Fisheries to work out our differences and examine each others' solutions.

Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you, Mr. Lyng. That is a very fine statement. We will talk to you and Mr. Olmer as soon as we get back from one of the momentous votes we have. We will be right back.

[Pause.]

Chairman GIBBONS. All right. I find these hearings so interesting it is hard for me to stop talking. I am sure the other members feel the same way because I believe we are talking about very vital things in our society, items that are on the top of the legislative agenda as far as this Congress is concerned.

Mr. Lyng, I particularly want to compliment you for your statement. I thought it was a very even, candid approach to our agricultural problems. I know you have been very successful in opening that market over there, and I know also that there is still a great deal to be done. But I am aware that we sell a great amount of food to the Japanese market and they are good customers. They pay good prices to buy good products. I have noticed in my 12 years of visiting Japan that there is a substantial increase in American products on the shelves of Japanese stores and in their markets. So, I am able to recognize that a great deal has been done.

I am also aware because we visited the citrus growing area of Japan this last time and also the cattle area that there was an awful lot of political support for their citrus growers and cattle raisers. We did not see many cows, but we did see an awful lot of citrus. While it is not the kind of citrus I am used to seeing, the huge groves with huge trees growing citrus, it is impressive. It is very colorful, very beautiful and, obviously, well tended. There was a great deal of pride as well as a great deal of expense going into that citrus crop.

I have listened to the arguments of the LDP for so long I can practically give them as well as they can on that issue, so I will not bore you with that, but I wish you good luck with those negotiations.

Mr. LYNG. Thank you, Mr. Chairman.

Chairman GIBBONS. Knowing it will help us all, let me say, Mr. Olmer, let us go back to autos. We were there when the famous auto statement was made that they were liberalizing their import policies on autos, and we immediately jumped down their throats saying they really have not done anything. They responded as if they were sincerely disappointed and hurt. They thought, as best as I could examine personal behavior, that they had made a large concession to our manufacturers, but we disagreed with them and we carried on a very intensive conversation with them.

I sometimes think I am not even in the same world when we get to discussing these things, and I told them so. But it is your conclusion, I assume, that your staff has closely examined the automobile concessions, and you have concluded that they have done relatively little for us. Is that right? I do not want to put words in your mouth, but I would like to hear your opinion.

Mr. OLMER. The short answer is yes. They have done relatively little. Perhaps a slight elaboration is in order.

We are still examining it because when first announced it did not come with the details required to properly assess it, and I am advised by staff that many hours have gone into discussing with Japanese officials exactly what is meant and how it will work. But the fact is we sell something less than 4,000 cars a year to Japan in any event. So, what we are talking about is the issue of equity, not the issue of substantial new sales of U.S. autos into Japan. We are talking about the process of receiving reciprocal treatment from the Japanese initially on the sale of automobiles, and I would hope very quickly.

Beyond that would be the subject of automobile parts which are also subject to a variety of certification and time-consuming and expensive procedures which contribute to making our products less competitive and attractive. I think there is the potential for substantial export sales in that area. I do not believe it will come in the area of automobiles per se.

Chairman GIBBONS. Let me say I protested very strongly the automobile liberalization they had made, because the best evidence we had at the time we were there was that they had done very little as far as U.S. manufacturers were concerned. As I say, I know that they responded as if they were truly hurt because they felt they had done something to remove types of discrimination.

The conversation went on so long and got so deeply involved with so many different Ministers, including the Prime Minister, that a couple of times I did not feel like I was talking about the same subject they were perhaps talking about. I would hope in USTR and in your operation you follow through vigorously to make sure that if there is a misunderstanding, we get it ironed out because I detected on the part of the Japanese that they wanted to iron it out.

It was to the best I could tell a very sincere desire on their part and a very deep disappointment they were not satisfying us on that issue. So, I realize it is not of great dollar significance, but it does have a high political significance that we get this matter straightened out. I would urge you, USTR and Commerce to go back and see what can be done to make sure we are talking about the right thing.

Now, on NTT we talked with the head of NTT, his senior staff people, and there again we came away with very conflicting opinions. We had been told one thing in this set of hearings and when we got over there we were told an almost diametrically opposite thing.

The head of NTT told us he was going to visit the United States, I think, in June. At that time I am personally going to ask him and the American manufacturers to sit down in the same room together and to see if we can talk in the same tones because there again we have a deep conflict about evidence we have received here and evidence we have picked up in Japan about NTT progress.

I do not want to go into all of the details of it because I do not want to slander anybody, but it created grave doubts in my mind here again that we were talking about the same subject matter.

That brings me now to targeting. I want to commend you for what you have done to throw this whole item of targeting high on your agenda. It is certainly high on the agenda of this committee. In fact, we have told the Japanese and the Koreans, and we have tried to tell the rest of the world that we are going to take some kind of action within the General Agreement on Tariffs and Trade [GATT] to try to discourage targeting.

I look upon targeting as being a very sophisticated way of granting a bounty or a subsidy which is outlawed under the General Agreement on Tariffs and Trade and outlawed under our almost 100-year-old law. Perhaps we have just not vigorously enough enforced that law.

We have had some, what I think, were very good hearings with your Mr. Horlick. He was an excellent witness the other day when he was here. We are going to try to find ways working within the GATT Subsidies Code and with the administration to find ways to improve the operation of those unfair trade practices laws.

So, while we are not in the position now that we can begin to put a lot of things down on paper, it is my objective that we be able to do that by the end of this year, and (1) reduce the cost of these proceedings to the U.S. industry; (2) speed up these decisions—that is going to be difficult—; and (3) perhaps increase the certainty and remove the chances of political influences.

Now, Mr. Horlick said he had not had any political influence exerted on him or his administration of these laws during the time he had been in office, and I believe him, but it is always possible to go back to the old practice that bothered us so much during the last sixties and seventies where the agency never got anything done because of apparently an overriding political pressure.

Mr. **Frenzel**. It was a different agency.

Chairman **Gibbons**. Yes; I hasten to say it was a different agency. That is the reason we moved administration of these laws into your agency. We commend you, Secretary Baldrige, Mr. Horlick, and all of the people who work for them for having done a far better job with those laws than anyone has done in the past. Having said that, we will have to do a lot better because I am going to try to get targeting within the purview of those laws. I know that will be difficult.

That is what I have in mind. You can comment on any of those: autos, NTT, targeting. Take your choice.

Mr. **Olmer**. First, I would like to thank you very much for those kind remarks about the operation of import administration within the Department. We have spent a great deal of time deliberating how to make an effective instrument the Government's trade policy, and I think in many, many respects we have succeeded.

One comment I would make regarding the absence of predetermined decisions or of influence on the people who do the analysis. That would suggest a political element. It was my feeling from the very beginning that, if we wanted to create an organization of high morale and intellectual openness, that we had to let the people at the lowest level of analysis know that there was intellectual honesty in the entire process.

Fortunately, Secretary Baldrige believes that completely, and we do keep hands off. By far the vast majority of decisions on cases are performed at a relatively low level of departmental operation. That is, Mr. Horlick has the authority to render judgments on the vast majority of cases which are processed.

I have some reservations about the utility of the countervailing duty law or the antidumping law relative to the concept we are just coming to understand, which we have labeled targeting. If there is a subject about which more people disagree, I am not sure I know what it is, in particular, people on this side of the Pacific with those on the other side. The Japanese are not at all at an official level, at any rate, dissembling when they discuss this with us and describe their uncertainties as to what we mean and why we think it is unfair.

More to the point of the applicability of the law is the way in which the statute is written, and I do not yet see, although I appreciate the opportunity to work with you to see whether we could not revise it. In the field of high technology in which this targeting practice is most prominent, the scale of production is so enormous relative to the size of the governmental subsidy. Indeed, as I said in both my oral statement and in the more elaborate written statement for the record, the size of the Government's subsidy is not per se the key of success.

Chairman **Gibbons**. You are talking about the direct cash subsidy. I am talking about the inkind type of subsidies, market protection, selection in elimination of—it is the whole selection process, the protection of the process as it is nurtured. All of those, in my opinion, are just the same kinds of bounties and grants. They have the same impact as a cash subsidy.

Mr. **Frenzel**. If the gentleman will yield, I think the credit allocation is perhaps most important of all.

Chairman **Gibbons**. The credit allocation, all of those things have measurable, and as I understand the interpretation of our countervailing duty laws, it is not the size of the grant, it is the effect of the grant that is what we measure. It seems obvious that this targeting, while it has not always succeeded, in the times it has succeeded can be directly measured in its impact on our products.

That is what I will attempt to get at. I realize you point out targeting in high tech is an upcoming problem, and they are passing laws through the Diet today that will in effect target high tech in the electronics area and in the biomedical field that we can measures these. They are bounties, and they do cause injury in this country. I think that without straying from the confines of the General Agreement on Tariffs and Trade, we can measure them and we can countervail them.

Mr. **Olmer**. Mr. Chairman, as you have sometimes said to me, I am glad to have your statement for the record. I think that is a most encouraging observation on your willingness to consider increased flexibility in the interpretation of what is a subsidy, and I think that is what we are going to have to get at.

Chairman **Gibbons**. I think that we are. They realize that they cannot subsidize directly by cash grants because we will call their hand on it, so they have gone to a more sophisticated system but certainly the impact is the same.

In fact, the impact may be greater because it is harder for us to detect, but it is still there. I will be working to see if we cannot properly identify and properly change those tests.

Mr. **Olmer**. We have an interesting example confronting us now emerging as we watch it and that is the field of supercomputers.

Chairman **Gibbons**. Yes.

Mr. **Olmer**. It is a field which began in the United States through the genius of some few Americans, and there are only a couple of companies that have entered that market. At last count, Japan had a maximum of three supercomputers in use, perhaps two.

They are targeting, if you will, two companies to produce supercomputers, and I can sit here and be almost certain that the size of the Japanese market for supercomputers between now and say 3 years from now is going to grow by 300 percent. The participation of a couple of American companies who began and who are today without any question leaders in the world in supercomputers—the Europeans do not make them at all—probably will not sell any but one or two while these Japanese companies are providing for this new market development.

Chairman **Gibbons**. We have some reports, some of which are classified; I will not identify them any further than that, that shed a lot of light on what is going on. I want to commend you and the Japanese for setting up this group to look at that problem and see if we can avoid problems. I think that is very fine and constructive. We will be monitoring that along with you, but I am determined we not only send the word to the Japanese but to everyone who intends to emulate them on industrial policy that we are just not going to put up with that any more.

It may have been acceptable after World War II in order to rescue the economy. It may be acceptable for little bitty developing economies to have to do this kind of thing, but for a full-blown economy like Japan's or ours to set out a target and do it in a sophisticated way, it is time to call a halt to that.

Mr. **Olmer**. Mr. Chairman, if I might, I think, one of the aspects of what you are saying is something I share completely. That is what we need to do is look at the consequences of those activities.

Chairman **Gibbons**. Yes.

Mr. **Olmer**. Not to rail against them. If they are contained within a domestic economy, it is their business if that is what they want to do in Japan.

Chairman **Gibbons**. Absolutely.

Mr. **Olmer**. But when it carries with it explicitly and implicitly the need to succeed, and success means dominating in many respects the American market, then I think we do need to look at the consequences of that industrial policy.

Chairman **Gibbons**. There is only one place I would differ from you in that, and this is a minor point. To the extent their targeting denies us a fair opportunity to go into their market, then I believe that violates the General Agreement on Tariffs and Trade.

Mr. **Olmer**. That is affirmative.

Mr. **Gibbons**. So, I track you exactly. They can have industrial targeting if they want it as long as it does not, through its operation, violate the General Agreements on Tariffs and Trade. If we need to change our law, and I believe we do need to, I am one person on this committee who wants to change it. That is the highest thing on my agenda because as I look down the road unless we send a positive signal to all industrialized countries that we will not tolerate subsidies, the subsidies are going to be a bigger plague to us in the future than the tariffs ever could.

They are going to be very disruptive, economically and politically, and cause a dog-eat-dog type of attitude between industrialized countries, and I think it is important to the health of our general economy and political stability that we not further tolerate or encourage subisides.

It will be difficult. It will be tough. I did not want to talk all day, although I have almost succeeded.

Mr. Frenzel?

Mr. **Frenzel**. Thank you, Mr. Chairman.

Thank you, gentlemen, for your excellent testimony. Secretary Lyng, I think your statement is well taken. You indicate that our trading partners who represent our largest market do not seem to be working on the same frequency with us, and obviously we have a great desire to protect our markets, but the Japanese do not seem to care.

I would like to commend you and your department for your persistence in staying with the problem. I hope that, as you suggest, you are dealing with the hides problem, that you begin to use the relief mechanisms available more vigorously, because whatever the attitude of the leadership of the Japanese Government seems to be, the last agency to which that direction seems to filter is the Ministry of Agriculture in Japan. No, they are not the last. I think the Ministry of Health, and maybe the Finance Ministry, but certainly Agriculture is down at the bottom of the list, and I commend you for hanging in there, and I think the tougher you work, the more results you are going to have. I think your testimony was particularly good.

I would like to say to Secretary Olmer, when we were in Japan, the leadership FCS position in our Embassy in Tokyo had still not been filled. My guess is by perhaps day after tomorrow it will be, but the other part of the equation and the criticism the Japanese most frequently level to us, with, I think, some justification, is that Americans have not gotten off their duffs and gone over there and tried to work that market with what I think is the necessary enthusiasm, nor have we furnished proper support for them.

Can you tell us something about the FCS? Was the late filling of this position an anomaly? Do we have a good program going there, or did we make a mistake when we set it up?

Mr. **Olmer**. The reason it has taken so long to fill it is that we—I said that I would make the selection personally, and I wanted to interview the candidates, and I wanted the very best person we could possibly obtain. We came very close a couple of times, and the candidate in one instance backed out, and in the other instance I did not think was good enough.

I had an appointment at 11:30 with the fellow who will be leaving very shortly, Mr. Bill Rapp, who has been a vice president of Morgan Guaranty, and, I believe, of Bank of America. An acknowledged expert on Japanese finance investment banking and trade matters. He has testified before Congress on a number of occasions. I think he will make a major difference in the way in which the U.S. Government projects and protects its trade interests in Japan.

With respect to the rest of the activity over there, I think they do a pretty good job. I think it could be better. They tried to increase the number of resources in the FCS in the Embassy in recognition of the importance of our market, and we were, as we put it some time ago, shot down in our recommendation to increase the size of the staff.

On two occasions we lost the appeal. The Ambassador did not feel it was warranted. Now, that is a judgment call, and I continue to think that we need more people, and I will, when I go out there next month with Secretary Baldrige, use the occasion to lobby for it again. There is a limit to what the FCS can do in Japan, no matter how many people we had there and how well familiar they were with Japanese business activities and the Japanese language.

I have said on a number of occasions if every single businessman who ever tried to sell in Japan spoke perfect Japanese and worked his fingers to the bone, I do not think it would have made a heck of a lot of difference in the amount of United States exports into Japan. They have not sold in Japan because the Japanese do not want to buy them, do not want to admit them. It has virtually nothing to do with the level of effort expended, because we have examples of, as you well know, United States industries that are competitive worldwide because they are good, and they have expended the same or greater effort in Japan, and nonetheless have failed.

It is sort of like the duck. If it walks like one and talks like one, I think it is a duck, and I think the market there is closed as a consequence partly of Japanese Government policy, as well as what operates beneath the surface, but we have got to keep working to improve the FCS.

If you are asking more generally what is the prognosis of the FCS worldwide, one of the largest doubters I have ever met of the effectiveness of U.S. commercial representation is none other than the Deputy Secretary of Commerce, who just spent his, I think, last week in Brazil, his first occasion on a trade-related matter.

He came back, I would not quite say bubbling with enthusiasm, but full of accolades, and said, I guess things have changed since I was a businessman trying to use U.S. Government representatives in embassies.

Mr. **Frenzel**. That is welcome news.

Mr. **Olmer**. I mean to tell you he was a very sharp critic, and came back a believer. I think you would find that to be true in many, many of our major posts, and as I think you are aware, we now have a situation in which roughly half of the foreign commercial service officers come from the private sector, either people who have had substantial experience or recent retirees who want another career. They are not all 100 percent. They are not all a plus. But some of them are just terrific.

Mr. **Frenzel**. I might say, parenthetically, to Secretary Lyng that one of the reasons we split out the FCS was because we felt the Agricultural Service was doing such a good job in our Embassies abroad. Obviously, you would like it to do better, and so would I, but that was really sort of the model, because it seemed to be a good deal more effective than our commercial counselors or whatever we called them in the Foreign Service, since their path to glory was quite different from the commercial one.

The commercial job was just sort of a rung on the ladder or a holding pattern while they moved up in other ways. Secretary Lyng, is the Foreign Agricultural Service still as strong, and are you satisfied with its performance? We find it is praised highly when we go abroad.

Mr. **Lyng**. Mr. Frenzel, I am pleased to say that I think it has never been stronger. It is pure coincidence that just this week I asked the Administrator how he thought it was going, and his observation was, it was doing quite well. I have traveled a fair amount, and I am very much impressed with the counselors and attachés we have. He told me—he is a careerist who is now the Administrator—that he does not think it has ever been better.

I think he is running a superb service.

Mr. **Frenzel**. That is good news, too.

Lionel, I am going to leave self-certification to Mr. Pease. He is now our expert, after our recent trip, but I would like to get at NT&T and repeat to you what the chairman did. We came away from that meeting really in complete befuddlement. We thought the only way we could get at the problem is to meet with Dr. Shinto when he comes to the United States. He has indicated he is willing to do so, and he will be here early in June, I think.

We just had to retire in confusion because of a totally different set of facts or allegations on both sides, and I am hoping that your department can help us by perhaps gathering together the experiences of American bidders at NTT, realizing, of course, that there may be proprietary stuff you cannot tell us. That is fine. But we would like to have some general knowledge about the bidding. Can you provide that for us?

Mr. **Olmer**. I think we——

Mr. **Frenzel**. Not immediately. In sort of general form.

Mr. **Olmer**. I think we could just about do it immediately. We have been working with USTR in the development of an in-depth analysis of U.S. experience with NT&T in preparation for what we anticipate will be careful scrutiny by the Congress when the agreement comes up for renewal. The spade work in this report by the two agencies has been done. It needs some scrubbing, and I would think within a very short period of time, I mean, a matter of a few days or weeks, we should be able to make available to you everything you ever wanted to know about the American business experience.

Mr. **Frenzel**. That would be very helpful. On the basis of the dollar volume generated, we certainly do not need the agreement, if that is what the agreement is going to produce. We have been wasting our time. And I know you have some strong feelings on the matter as well.

[Mr. Olmer nods affirmatively.]

Mr. **Frenzel**. With respect to targeting, we have talked about industrial targeting, and the chairman, I think, probably has a stronger position than I do on it, but I share some of the feelings he has, particularly when it is a coordinated process that involves closing up the market and allocating credit, and it involves some coordinated research by grant, which is not terribly important, and then involves a coordinated attack, literally a sacking of a foreign market, rampant pillage.

It is almost a military type action. It seems to me that is something allies and trading partners should not be indulged in, and that is what gives us pause. On this committee in the past we have not liked to violate our own agreements, and we have tried to persuade our brethren not to violate their agreements, so our chairman is trying to stay within the framework of our international agreements.

I think it will be a very difficult job, and I am not sure we can do it, but leaving that aside temporarily, we are talking here about the growth industries of the future, but while we talk, the Diet is either passing or has passed a similar sustaining legislation to protect the stressed industries in whose markets we should now be competitive, but we will not be because they will be sheltered by the Japanese in an inverse situation, because they are going to be phased down or protected.

Do you have some counsel for us for the Japanese relationship in that sort of operation? Who is getting hurt there? Our chemical companies? Our lumber companies?

Mr. **Olmer**. Aluminum, petrochemical, paper and paperboard, and soda ash. One of our favorite subjects, industrial chemicals.

Mr. **Frenzel**. Is that the same kind of gig as the other?

Mr. **Olmer**. Well, it is the flip side, and it does not represent necessarily growth in the future, but the Japanese are doing the right thing in many respects. You have to admire the process that looks rationally at overcapacity and noncompetitiveness, and says we need this. There are a lot of workers we want to provide sustaining employment. What do we have to do to make it work?

Well, you have to cut it by two-thirds, and you have to provide loans for investment, research and development, new tooling, and so on. The problem is, as you point out, and the chairman pointed out, it oftentimes results in sheltering that declining industry from U.S. exports which have a legitimate, internationally recognized right to access.

I mentioned soda ash. I think that is instructive in a number of ways, because it was over a year ago that I suggested to my counterpart in MITI that we together look at a number of different industries in the United States that had made an effort to succeed in Japan and failed, and by experience elsewhere in the world were successful, and one of the industries we quickly came to an agreement to study was soda ash.

It took us about 6 months to develop a report on the soda ash industry in the United States and its experience in Japan, which both sides agreed to as to the basic facts, about 6 months of extremely hard effort on our part to satisfy objections by the other side, and our conclusion was, we should have been able to sell, and that in fact there had been a cartel established.

A year later, we now find the Japanese Fair Trade Commission examining the cartel in soda ash in Japan, to make an assessment as to whether it is illegal and whether it ought to be stopped, but meanwhile our exporters have not had very substantial increases in success. We pick away one by one. I do not know—well, I know I will not have enough years at it, and I doubt that a lot of others will have enough years to go consecutively, one industry at a time, one product at a time, and examine all of these things sequentially.

So, I think that the chairman's idea of examining our legal process and the existing international norms is really the way in which we will have to approach it.

Mr. **Frenzel**. We have been thoughtful on it, too. We did not spend a lot of time on cigarettes. That is just another example where you make a deal which is not a very good deal for us, and then we find our trading partners abrogating the deal and doing everything to see that it does not get carried out.

I am getting, I guess, as discouraged as many people around here and you are about approaching this one at a time, and I guess, like the chairman, I want to find a response on our side that is consistent with our international obligations. We have been to Japan a lot. We have taken our complaints, and our complaints have not been handled in the way you would expect an ally and trading partner to deal with us. I assume that has been your experience.

Mr. **Olmer**. Oh, indeed. Indeed, it has. I might say I detect a growing impatience on the Japanese side, not to say a certain measure of arrogance, making these sweeping assertions that have to be interpreted as unfair trade practices on their part, and I do think we have a responsibility to be specific, but I think the specific ought to be permitted to make the general rule from.

Mr. **Frenzel**. I agree with you. I am tired of presenting to the Japanese a long list of things and having them pick No. 23 off, ding around with it for a couple of years, give us one-tenth of it, and tell us they have answered all of our objections. That is the normal routine.

It is a shame that we have to deal in this way. I hope it will not be this way forever.

I thank you for your testimony, and I am sorry for having used so much time.

Chairman **Gibbons**. Let me make an administrative announcement here. I do not see how it is possible to finish the rest of the panels this morning, so Ambassador Smith, Ms. Constable, and Mr. Mendelowitz, we are going to have to excuse you. We will try to arrange for you to come at another time, and we will try to do it soon. We will want to continue this. So we will excuse you now, and we will try to complete the questioning of you two gentlemen.

Mr. Olmer, we realize we have kept you through an appointment. We wanted to hear from all of you, but there is no possible way today. We will rearrange this as soon as it is convenient for you and the committee to get back together.

Mr. Jenkins?

Mr. **Jenkins**. Mr. Chairman, I want to thank the panel for their testimony.

Mr. Olmer, you presented a lot of good facts. I think your testimony was excellent in pointing out some of the real problems we have had and continue to have in dealing with Japan. From your testimony it is almost obvious that Japan's market is practically a closed market almost by governmental policy as well as circumstances within Japan. I think while it is not for us to talk impolitely, we must deal with things you recognize with a tougher stance if we are to get any action.

I see so many things. We could talk about NT&T. The only thing we can look at is the bottom line. Since 1980, as you point out, out of $6 billion of procurements, in 1981, according to testimony, we sold a grand total of 3 million dollars' worth, and during those 3 years, we sold $17 million out of $6 billion.

I see that with automobiles and automobile parts, in 1982, the total volume would make up almost 70 percent of every dime that we have traded over there just out of one area.

When I look at the agricultural sector, which is the bright spot we have, and I compare the volume of yellow corn between 1978 and 1982, we are roughly the same, $1 billion to $1.2 billion. In soybeans, we have gone from less than $1 billion in 1978 down below to $980 million. In wheat, we have gone from $450 million up to the grand total of $560 million.

I do not know how long we can continue to open the markets like we do when Japan takes the position you can only sell cigarettes at certain retail places if they come from the United States. Maybe we should say you can only buy Toyotas in Alaska. At some point we have got to play a little tougher than we have.

I like to be liked. I like to be nice. I hear statements made, we are going to review, we are going to do this. Everyone knows 3 years down the road we will still be reviewing, and our situation has not improved. I am just disappointed, and all of us are, overall with the trade aspect with Japan.

Mr. Lyng, on the hide situation, we went from $233 million in 1978 down to $207 million in 1982. What about 1983 for the sale of hides?

Mr. LYNG. As I mentioned in my testimony, Mr. Jenkins, we for a long time have appealed to the Japanese for improved hide markets. We are not achieving that. We have had a series of meetings. The last was yesterday, I believe, in Geneva. At least it was yesterday. I am not sure where. And we have made a decision to go ahead with the filing with GATT.

Mr. JENKINS. Where is the real bright spot in agriculture in the last 6 years? Has wheat been increasing? Automobiles, $900 million in 1978 to $1 billion plus or so.

Mr. LYNG. As a matter of fact, our agricultural sales with Japan approached $7 billion, almost $7 billion in 1981, and fell off by $1 billion, thereabouts, in 1982.

Mr. JENKINS. That is a bright spot when you look at the fact that we lost in four-passenger cars alone in 1982 $7.9 billion, which all of agriculture products totaled. I understand the frustration in the automobile area. I just think it is unfortunate that we have this situation. I think we need to be very firm in some of these areas. I just do not see the bright light that a lot of people apparently see. I tend to be a little bit more diligent than I have in the past when we talk about opening up our markets to Japanese products until I see some difference with Japan.

Chairman. GIBBONS. We will break.

[Whereupon, a brief recess was taken.]

Chairman GIBBONS. All right. Let us proceed.

Mr. Pease?

Mr. PEASE. Mr. Chairman, thank you very much.

I think most of us on the dais, instead of questioning the witnesses, have wound up making statements. I think Members of Congress are expressing a high level of frustration, which I gather is shared by you gentlemen as well. I thought the testimony from both of you was very good.

Mr. Olmer, you said in your testimony, reciting the history of the Government of Japan's trade liberalization measures, that the first one in January 1982, apart from some important progress in certain areas, the package contained virtually no new initiatives of interest to the United States.

In the next one, in May, you say the package was very short on specifics, and then you say there were subsequent talks which did not yield much evidence of action by Japan. You go on to say, in December, Japan announced unilateral tariff reductions on things like cigarettes and chocolate, but then you go on to say that a surcharge was imposed which will offset some of the benefits on cigarettes.

Mr. Lyng, in your testimony, you point out that whereas we have proposed quick direct action to alleviate discrimination against imported products, Japan has frequently denied that such discrimination exists, and underestimated its severity and overestimated the negative side effects of corrective action, and then applied only as much relief as would make Japan comparable to other leading importing countries.

It seems to me that what the statements of you two gentlemen say pretty clearly is that the Japanese are dragging their feet. They are stonewalling it. They are doing only what they have to do, improving by small increments, not looking at the big picture.

In your statement, Mr. Lyng, you are very conciliatory toward the end, which I guess is appropriate when you are talking about your biggest single customer, but when you talk about manufacturing goods, it is certainly not the case.

Along with other colleagues here, I wonder how long we have to sit back and be nice guys about it and talk about our devotion to principles of free trade, the GATT, and so on, and suffer from this kind of footdragging. How long do we have to wait? When are we justified in taking some direct steps to offset this clear pattern of footdragging?

Mr. LYNG. I do not think I would want to set some ultimatum in terms of time, but I do think in terms of attitudes of the U.S. general populace that time is definitely running out. I pointed out that our patience was wearing thin. When I said our, I was referring to my view of the people of the United States, not just those of us at the Department of Agriculture, or just those who wish to ship more beef and citrus.

When you go to get on an airplane to go to Japan, from whatever port of embarkation, there is always a freezer in the duty-free shop full of New York strip, sirloin steaks, and other meat, and it is the most popular thing that Japanese take to Japan. It is a symbol of the fact that the Japanese would buy more, and that they would pay huge prices for it. But the Government does not allow it to enter. It is a symbol of all that you have talked about.

I do not think they can keep doing that for very much longer.

Mr. **Pease**. Mr. Olmer?

Mr. **Olmer**. I would like to share my colleague's optimism that the Japanese cannot do it for much longer, but I think they can do it indefinitely, and I think they will do it indefinitely, and I am not sure there is much more that can be done, that there is the will to be done, than we have already put into motion, but I, as in a number of other areas, would bend over backward to avoid holding out unrealistic expectations.

In connection with a Japanese Government delegation, I took the occasion to review the historical record of what has been said over the last 10 years by Japanese Government officials and U.S. Government officials, and it is an embarrassing record, embarrassing for me as a present Government servant, and, I would hope, embarrassing to the Japanese, because beginning in 1972 there are these assertions: Japan is the most open market now. We have taken off all of the barriers. Oh, yes, it used to be that way, but it is not that way any more. I found statements by administration officials then and through the years telling the Congress how we have put in motion things which will solve it, and just hang in there a little while longer.

If that sounds as if I have developed a certain cynicism, I guess I have. I know of no alternative. There are so many things we value in our system that would be put at risk through a reaction to this attitude on the part of the Japanese that I think would outweigh the uncertain potential advantage. I know that a lot of U.S. Government officials regularly go to Japan, as this subcommittee has and a number of others have, and administration figures go regularly, and say essentially the same thing.

I believe that the Prime Minister presently, Mr. Nakasone, does believe that there is this serious problem, and is earnestly trying to do something about it, but I will tell you quite frankly, I have some doubt in my own mind as to whether the rest of the Government believes there is a serious problem, and whether or not the policy that seems to have served their interests over at least a decade and probably longer cannot be continued with relative impunity.

I do not know the answer to that. I do know that some of the things we have started hold high promise, but I would not be a guarantor of success.

Mr. **Pease**. I appreciate very much your candor on that point, and I think your frankness has shown through in your testimony as well. I must say I share your misgivings. I do not think the Japanese are ever going to really open up their market. I do not think they have any intention of opening up their market.

What we see announced from time to time are palliatives. There has been more pressure in the past couple of years, more protectionist legislation in the Congress, so they have increased the frequency of their pronouncements and their many steps toward opening up their market. Now, they do one every 3 months, but I am fully convinced if the pressure drops back down again, if the world economy picks up, they will slide right back into their former pattern, and in the meantime, what they do is only miniscule compared to what is necessary if their markets are really going to be open.

The frustration is, what do we do about it? As you say, we do not want to cut off our nose to spite our face, or shoot ourselves in the foot, or deny our consumers advantages of free trade. On the other hand, people have to earn a living in the United States in order to buy products, Japanese or otherwise, and if we give up our entire manufacturing sector to the Japanese, this will not be the same country we have known over the years.

It seems to me that while you do not know the answer at the moment, and neither do I, some answer has to be found. We cannot continue to tolerate this imbalance.

Mr. OLMER. If I might interject with just a small anecdote, I was doing Secretary Lyng's work also on behalf of some of Mr. Gibbons' constituents. On a trip to Japan in December, I was invited to be interviewed by the national television network, NHK, and I just received a videotape of it, and looked at it, and it was a pretty fair interview. They cut out sections on high technology that I would have preferred. The part they did include was my talk about citrus, especially, and beef, and at one point I said that I thought that the greater efficiency of the American citrus growers and processors in the United States could be a great benefit to the consumer in Japan.

Well, the videotape at that point had my voice as an overlay and, I presume, the kanji characters accurately depicting what I was saying about the greater efficiency in the United States, but the tape itself was showing the efficiency of the Japanese citrus processing community, and all of these people working with automatic equipment, bouncing oranges up and squeezing juice with automaticity and clearly low cost, contradicting the assertion I was making that it was in their benefit to buy more from us.

Mr. PEASE. That is very interesting.

Let me ask you a question or two based upon this handout we have entitled "United States-Japan Trade and Current Account Balances." I do not know whether this came from your shop or not, but in any event, I am sure you are familiar with the figures. I was intrigued. One of the charts shows a balance of trade, and the other one shows a current account balance. In 1980 and 1981, while both of those years we had a trade imbalance and a current account imbalance, the current account imbalance was about $3 billion less than the balance of trade, but for 1982, the negative balance for trade is listed at $17 billion, and estimated for the current account at $16 to $17 billion.

It seems to indicate that whatever we were doing to earn money previously on a comparative basis in the noncommodities category is not happening now. Would you happen to know why it is that that gap is being closed?

Mr. OLMER. No; I do not. I think it is worth looking at. I will be happy to do that and provide you with whatever answers we come up with.

Mr. PEASE. I am just wondering, looking at that, if the Japanese are not talking on one hand about opening up their manufacturing markets while figuring out some other way to close their markets in services.

I want to refer to the charts entitled "Leading Items of U.S. Imports or Exports." I find these charts very instructive. They list the 30 top items of imports from Japan which represent $18 billion out of $37 billion of imports in Japan. So, it is about half accounted for by 30 items. Of course, those imports from Japan are all manufactured items, every single one. And two-thirds of that $18 billion, $12 billion, is in automobiles alone.

If you look on the other chart about U.S. exports to Japan, out of the top 30 items only 7 are manufactured items. All the rest are essentially raw materials, and that accounts for $1.6 billion out of $10 billion, being the top 30 items among exports.

It seems to me that that record almost speaks for itself. If they are really serious and sincere about opening up their markets, there sure has not been much result so far, and while obviously we want to sell our agricultural produce, I do not see how we can tolerate in the long run remaining a supplier of raw materials to Japan and a purchaser of manufactured products.

Then, I would note in 1981 one-half of all of our manufactured products that went to Japan was in airplanes, one-half. It is down in 1982 because of the recession, I presume. One-half in 1981 and what industry does the Japanese Government select to target for the future? The aircraft industry.

It seems to me that, as I said in Japan, the Japanese Government well knows which nation in the world is the leading exporter of aircraft. It must know that when it targets that industry, it is targeting the U.S. export market for aircraft. I do not see how we can help but judge that to be an unfriendly, predatory act.

I wonder what, if anything, we are saying to the Japanese about their specific decision to target commercial aircraft.

Mr. LYNG. Before I leave that to my colleague to answer, Mr. Chairman, I wonder if I might be excused. I am supposed to attend a Cabinet meeting at 1 o'clock at the White House.

Chairman GIBBONS. Yes, sir.

Mr. LYNG. I have enjoyed being with you, and if it is OK, I will leave.

Chairman GIBBONS. We will be back with you. We will not let you be lonesome. We will be on this subject for some time.

Mr. LYNG. Thank you very much.

Chairman GIBBONS. Thank you for coming. Good luck.

Mr. OLMER. Mr. Pease, to the best of my knowledge and belief, and I can tell you no one in my department and I do not believe anyone else from any other agency of the U.S. Government has suggested yet to the Japanese that it is an unfriendly act for them to try to develop an aircraft manufacturing capability that would have export potential.

We have strongly described what we do consider to be unfriendly, and that is the inability of small aircraft manufacturers to get access to the Japanese market while they are presently developing a business jet capability in Japan. I do not know that we would be prepared to say as a matter of U.S. Government policy—in fact, I tend to think we would not do that—that they should not go ahead and make the effort.

The competition might be good for the American aviation industry, so long as it is not done in an unfair, predatory way which protects the home market and provides incremental subsidies, and the whole range of things we talked about in the concept of targeting.

I have said to leaders in the U.S. aviation industry, what do you think of Japan's goal to be a world class competitor by the year 2030 in major aircraft, not just business jets, and I get what I consider to be nothing short of an astonishing answer. I do not think they will make it, is the response I get, and I am not by any means an expert in aerospace, but I say, based upon the experience and track record in so many other areas in which the Japanese were alleged to be inferior to the United States or other world producers, why do you have such confidence?

And I do not get an adequate answer to that second follow-up question, but I certainly think that we need to put in place today over the next year or 6 months the kinds of guidelines in our trade laws, such as the chairman was talking about, that will prevent that eventuality as a consequence of targeting practices.

I might add in my testimony I refer to military coproduction. As you may know, in the trip report I wrote after my visit I described the visit to the Mitsubishi plant in Nagoya in which they are manufacturing under a coproduction agreement with the U.S. Department of Defense and McDonnell Douglas the F-15 fighter aircraft, a magnificent piece of high technology machinery.

Within a baseball throw from that hangar they are developing a world class, I think, 7- to 12-passenger business jet to sell for around $1.5 million, $2 million, which is going right to the heart of our leading business jet manufacturers, such as Cessna. The Japanese claim there is no transfer, and I said that is simply not credible. You cannot say that. There has got to be simply in the manufacturing know-how and in the experience of building aircraft. Sorry for the——

Mr. **Pease**. No; I think that is worthwhile. It will come up. I guess the assurance you received from U.S. aircraft industry people reminds me of the assurances we were getting from Ford, General Motors, and Chrysler back in the early seventies that imported cars were never going to be a major factor in our market.

Mr. **Olmer**. Mr. Pease, I think if you would permit me to add a footnote, if we in 1965 to 1970 had insisted on access to the Japanese market for our automotive manufacturers, we would not today be confronted with a 22- to 25-percent market share of the Japanese auto manufacturers in this country.

Mr. **Pease**. I would like to switch to self-certification for automobiles. We talked to the Japanese a lot on that subject when we were in Japan just recently. They claim that they cannot move to self-certification because of societal differences, that there is an expectation in Japan the Government will have a responsibility for the health and safety of its citizens, that in Japanese society the Government is not allowed to pass that off to somebody else, in other words, a private corporation, to self-certify.

That sounds a little facile to me. What is the position of the Department on this matter?

Mr. **Olmer**. We do not accept that as an adequate response to what we believe is a basic unfairness. We need to continue pressing. There may be some room for give as, for example, Mr. Lyng was explaining just a few minutes ago. The United States is the world's largest importer of beef, and it requires the nations which export beef to us to establish a process of certification which is satisfactory to us, but then we allow them to do it. We have offered that to the Japanese in the case of baseball bats, and it was rejected.

I have no doubt if it was rejected in such a relatively simple product as a baseball bat, it would also be rejected, and it has been, in the case of automobiles, but I think we absolutely cannot accept from them as a response that we are not capable of in this country certifying the adequacy subject to their periodic inspection, and subject to their, well, happenstance look at any particular thing we do.

They are not yet ready to move, and that is the answer they give us as well.

Mr. PEASE. One last question, which gets a little bit into another area. In reading your testimony and listening to you respond to questions, I see you as a person who is under no illusions about what is going on in our trade relations with Japan, and a person committed to trying to open up their markets and get a more level playing field for our manufacturers, and yet a couple of weeks ago, when we had hearings on trade remedies, we had the American manufacturers come in and tell us they did not view the Department of Commerce as an advocate for them, or even a neutral party, but as a hostile party, in their effort to bring actions against unfair imports.

Can you comment on why you think that might be and whether you think there is any validity to their charge?

Mr. OLMER. Well, that is not what they tell me when they come to see me, except those that would like to see the Department self-initiate trade actions. We have said we have no real reluctance to self-initiate a trade action, but we must have some evidence, and you have got to be prepared to come forward with some proprietary information, for example, in the high technology area, and tell us what the true story is.

Unfortunately, they have not done that yet. They have not done it despite, I would say, an almost enthusiastic offer which I gave. Now, to some extent it is excusable on the grounds that information is not available to a private party. We have offered to help the acquiring of information that is not available, but our hands are tied as well, and unless a case is filed, we have no basis for demanding information, and the only way in which we can demand information when a case is filed is to say we will use the best evidence rule, which is what the plaintiff may assert, or what we determine through open sources.

It is a powerful instrument to compel the presentation of data, but we do need some fundamental presentation from the industry, which presumably knows its situation better than anyone else, and frankly, in the high technology area, they have not been willing to do it where they have, in a few cases now pending, one of which I am recused from because of my prior association with one of the companies who brought it, Mr. Horlich and his people went right to work, and as far as I know, they are doing a credible job to the satisfaction of the industry.

Oftentimes the U.S. industry just wants to vent frustration, I think, and I cannot imagine them having a more responsive element relative to their trade complaints than this Department.

Chairman GIBBONS. Mr. Pease, would you yield at this point for an observation?

[Mr. Pease nods affirmatively.]

Chairman GIBBONS. You mentioned self-initiation, and I have generally objected to self-initiation because I did not know where it would end. Would it perhaps be desirable to encourage you to self-initiate where there is targeting involved? Because sometimes this targeting impacts so far down range that perhaps the private industry has no concept that it is going to be injured, and perhaps self-initiation of at least an on-the-spot investigation may begin to pick up the flight of the projectile.

Mr. OLMER. It may require an extension of our concept of injury. It is rare——

Chairman GIBBONS. I am not talking about injury. I am talking about beginning to collect the information, and observe, and send out questionnaires where there is targeting involved.

Mr. OLMER. We are doing a pretty fair job of collecting data on the targeted industries, and that should be available shortly in a report which I would be pleased to send to the committee, but the actual filing of a legal complaint, for example, would necessitate an early determination by the International Trade Commission as to whether there was likelihood of injury. Then you get right to the heart of the question of the statutory definition of injury. If they would say the threat is not sufficiently present, or it is unlikely, that ends the case right there.

Chairman GIBBONS. Could we say that targeting is per se a threat, and then cause an investigation to begin? You could not take action, you could not levy a duty until there was some injury, but you could be ready to levy the duty. You would have the information. It would not take months and months of developing a case. That is one of the things our people seem to complain about.

Mr. OLMER. I think we are now talking about the sort of language crafting——

Chairman GIBBONS. Yes.

Mr. OLMER [continuing]. That needs to take place over the next months.

Chairman GIBBONS. So your answer, then, is sort of in the affirmative.

Mr. OLMER. Oh, yes. Oh, yes.

Chairman GIBBONS. OK.

Mr. PEASE. Mr. Chairman, I had just one more thing, and that was a follow-on to my previous question. As I recall, these firms complained about, they say, an almost adversarial relationship with the Commerce Department. They talked in terms of what happens when they file complaints. They felt that there was an overriding commitment to free trade. In their view, nothing could be allowed to interfere with this principle—maybe some foreign policy considerations extraneous to trade. The petitioners believe that at the bureaucratic level, the people who have been in it for years and years and years, have a mindset that you cannot allow any breach. They believe they are perceived by the bureaucracy as continually complaining, and without merit, and, therefore, the Government will not support their petition for relief.

Do you still protest innocence in that regard?

Mr. **Olmer**. I will give you a number. Out of 145 cases that were brought over the last 2 years, we had affirmative determinations in 140. It does not sound to me as if we blindly follow some precept of free trade.

Chairman **Gibbons**. What was the figure, 140 out of 145?

Mr. **Olmer**. I will have to double check, but it came to me because I answered a call from a Senator who, on behalf of the constituent, complained about the Commerce Department never finding in the affirmative, and it was something like in only five instances did we not find on behalf of the petitioner in I think it was a more limited area of countervailing duties, but I will get the exact number for you by the end of the day.

Chairman **Gibbons**. All right. Having said that, the rejoinder from the industry is, well, you did not find enough of a subsidy.

Mr. **Olmer**. Well, I mean, I hired good people to do very difficult, tedious work. They are instructed to call it as they see it, based upon the numbers and evidence presented to them. We have those numbers and the analysis double and triple checked, and the chips fall where they may.

Mr. **Pease**. Thank you very much.

Chairman **Gibbons**. Mr. Frenzel?

Mr. **Frenzel**. I do not want to say anything except to commend the witness for his patience.

Chairman **Gibbons**. Yes, Mr. Olmer, we appreciate it very much. We want to work with you and the people who are working on these unfair trade practices and see what we can do. This concludes the hearing for this morning and this afternoon also.

We intend to hold our next hearing in B-318 on Tuesday, April 26, at 10 in the morning, Rayburn House Office Building.

Thank you.

[Whereupon, at 12:55 p.m., the hearing was adjourned, to reconvene at 10 a.m., Tuesday, April 26, 1983.]

UNITED STATES-JAPAN TRADE RELATIONS

TUESDAY, APRIL 26, 1983

House of Representatives,
Committee on Ways and Means,
Subcommittee on Trade,
Washington, D.C.

The subcommittee met at 9:40 a.m., pursuant to notice, in room B-318, Rayburn House Office Building, Hon. Sam M. Gibbons (chairman of the subcommittee) presiding.

Chairman Gibbons. Good morning, ladies and gentlemen.

I just thought as we opened this hearing this morning that my shuffling the chairs was about as appropriate as what we are beginning to see happen in the executive branch on trade.

I feel a little more comfortable in this chair. I am not sure that I think any better but I think there is an analogy between what we now see happening. We are going to reorganize trade again. At least they say we are. That doesn't have too much to do with the hearing but I thought I would throw that out so everybody would know where I stand anyway.

Good morning, ladies and gentlemen. As you know, this is the Subcommittee on Trade of the Ways and Means Committee. This is our third hearing on the topic of United States-Japan trade relations. Our first hearing was held on March 10 of this year prior to the trade mission which we took to Japan during the congressional recess.

That trade mission to Japan had two principal purposes. The first was factfinding to gain better understanding of the conditions surrounding our bilateral relationship with Japan.

Our second goal was to explain to our Japanese colleagues the viewpoint of the U.S. Congress on both how controversial our trade relationship has become in the United States and the importance of increased access to the Japanese markets for U.S. goods if good relations between our two countries are to be maintained.

The purpose of our hearing today is to continue our investigation on the broad spectrum of United States-Japan bilateral trade issues. We want to focus on the current degree of openness of the Japanese market for competitive U.S. products looking at a variety of factors that might affect our ability to compete with Japan.

Examples are Japanese industrial policy, the current exchange rate relationship of the yen and the dollar, and other tariff and nontariff barriers to specific U.S. exports.

Our first panel of witnesses from the administration has been rescheduled from last Thursday. They consist of Hon. Michael B. Smith, who is the Deputy U.S. Trade Representative, and Hon.

Denis Lamb, Deputy Assistant Secretary of State for Trade and Commercial Affairs.

We will hear first from Ambassador Smith.

STATEMENT OF HON. MICHAEL B. SMITH, DEPUTY U.S. TRADE REPRESENTATIVE, ACCOMPANIED BY JAMES MURPHY, ASSISTANT U.S. TRADE REPRESENTATIVE FOR EUROPEAN AND JAPANESE AFFAIRS, AND JEANNE ARCHIBALD, OFFICE OF THE GENERAL COUNSEL

Mr. SMITH. Thank you, Mr. Chairman.

I am happy to have the opportunity to appear before the trade subcommittee on the issue of our bilateral trading relationship with Japan and to have this opportunity to discuss with the subcommittee the current status of our trade issues with Japan as well as the administration's trade policy objectives vis-a-vis Japan.

We value very highly the cooperation that this committee has extended to our efforts in seeking these objectives.

Mr. Chairman, last Thursday I submitted written testimony which is longer than the summary that I will present today and I ask that longer statement be put in the record.

Chairman GIBBONS. Yes, sir, we will put all of it in the record.

[The prepared statement follows:]

STATEMENT OF AMBASSADOR MICHAEL B. SMITH, DEPUTY U.S. TRADE REPRESENTATIVE

Mr. Chairman: I am happy to have the opportunity to appear before the Trade Subcommittee on the issue of our bilateral trading relationship with Japan, and to have this opportunity to discuss with the subcommittee the current status of our trade issues with Japan, as well as the administration's trade policy objectives vis-a-vis Japan. I might say that we value very highly the cooperation that this committee has extended to our efforts in seeking these objectives.

U.S. TRADE POLICY VIS-A-VIS JAPAN

The overarching goals of U.S. trade policy are to further the development of the U.S. economy and the economic well-being of Americans, and to maintain and strengthen the international free trading system. To realize these goals in its trade relationships with Japan, U.S. trade policy has five general objectives:

A. Obtaining overall access for U.S. participation in the Japanese economy in goods, services, and investment on a basis equivalent to that enjoyed by Japan in the U.S. market.

B. Ensuring trade composition and volume which reflect U.S. competitiveness.

C. Ensuring fair competition between United States and Japanese firms in the United States, Japanese, and third country markets, and eliminating distortive or disruptive effects that may arise from Japanese Government industrial policies or corporate practices.

D. Avoiding protectionist measures.

E. Inducing Japanese leadership in free trade commensurate with Japanese economic strength and Japan's stake in the system.

CURRENT STATUS OF UNITED STATES-JAPAN TRADE ISSUES AND NEGOTIATIONS

United States-Japan trade relations are currently characterized by increasing friction as a result of the continued presence of barriers preventing access for foreign goods, services, and investment to the Japanese economy, and exacerbated by the expanding bilateral trade surplus in favor of Japan ($17 billion in 1982, and projected at $20 to $22 billion in 1983).

The fundamental issue central to most current bilateral trade problems with Japan is the lack of access for U.S. goods, services, and investment to the Japanese market, equivalent to that enjoyed by Japan in the U.S. market. The administration has concentrated on increasing U.S. market access in Japan through intensive bilateral negotiations over the past 18 months.

In September 1981, the United States and Japan agreed to create the United States-Japan Trade Subcommittee, a subcabinet group, to meet frequently on pressing trade issues. Since then the group has met four times, most recently in early December of last year in Tokyo. These meetings have been devoted to defining the barriers to Japan's markets where U.S. products are competitive and to exploring ways to eliminate those barriers. In addition, a series of regular, nearly monthly visits to Japan by a working-level subgroup of the subcommittee was instituted in August 1982 to follow-up on trade initiatives taken by the Japanese Government. At the same time meetings of industry specific bilateral groups concerned with trade in high technology, manufactured tobacco products, forest products, and beef and citrus have been held to address specific problems in these fields. In the standards area, technical discussions have been held since 1979. And, as you are aware, we have recently had a series of high level visits between officials of our two countries, beginning with Prime Minister Nakasone's trip to Washington in January followed by trips to Tokyo by Ambassador Brock and Secretary Shultz shortly thereafter, in which bilateral trade issues were top priority items on the agenda.

EARLIER GOJ TRADE INITIATIVES

The Japanese have responded to a certain extent to our efforts to secure greater market access for U.S. products in Japan. In November 1981, Japan announced that it would accelerate the timing of tariff cuts agreed to in the Multilateral Trade Negotiations. Cuts scheduled for 1983 and 1984 became effective in April 1982. In addition, former Prime Minister Suzuki asked the Liberal Democratic Party [LDP] to establish a committee on export opportunities in the Japanese market. The first result of this group's work was the announcement on January 10, 1982, that 67 measures would be implemented to alleviate nontariff barriers, primarily in the customs and standards areas. An Office of Trade Ombudsman was created, with a specific mandate of responding to foreign complaints of inadequate access with a guarantee that there would be no delays and that action would be forthcoming.

On May 28, 1982, the Japanese Government announced a second package of trade liberalizing measures covering a broad range of sectors and nontariff barriers. It contined a series of "generic" remedies the Government committed to take—many of which we had urged for some time. At the time of its announcement, former Prime Minister Susuki issued a statement suggesting to his people that it was time to change their attitudes towards foreign products, thus giving a significant political thrust to the action. Followup discussions with the Japanese Government have revealed substantial progress in certain areas, such as customs procedures, but little or no progress in many other areas of particular importance to the United States. While these initiatives have been steps in the right direction, no major market opening has yet resulted. However, the new government of Prime Minister Nakasone has taken a markedly more active approach to the market opening issue. If implementation of some of the commitments recently made, especially that to revise Japan's national systems of product certification, is carried through, substantial progress in reducing some major formal barriers to U.S. exports to Japan sould ensue.

Let me briefly review these most recent trade initiatives undertaken by the Japanese Government under the new leadship of Prime Minister Nakasone, as well as the administration's efforts to secure greater market access in Japan.

RECENT INITIATIVES

The most recent GOJ trade initiatives were contained in announcements made on December 25, 1982, and January 13, 1983. It is important to note that a number of the measures contained in these initiatives were included despite serious domestic opposition both from affected interest groups and from within the Liberal Democratic Party [LDP]. In several cases, Prime Minister Nakasone personally intervened in the decision to override the opposition and to strengthen specific commitments.

DECEMBER 25 TARIFF MEASURES

The Christmas Day initiative consisted of a set of tariff reductions and eliminations. (For a detailed assessment, see Attachment A.) The items of greatest trade interest affected by the cuts are certain paper products ($140 million in U.S. exports to Japan in 1981), magnetic tape ($35 million), chocolate ($10 million), and manufactured tobacco products ($60 million). The reductions on chocolate and tobacco products, while less than the U.S. industries would have preferred, are substantial and could afford an appreciable increase in market access for these products. The reductions in the tariffs on paper products, although affecting a substantial amount of trade, are quite small in magnitude and promise a modest increase in export opportunities.

Regarding the tariff reduction on manufactured tobacco products, during Prime Minister Nakasone's visit to Washington he stated his intention to ensure that no actions would be taken to circumvent the benefit of the reduction. He made the commitment in response to our express concern about reports that increases in several charges on import products, particularly on the retailer's margin and the profit margin taken by Japan's tobacco monopoly [JTS], were being considered that would have the effect of negating the 30 yen per pack price reduction on imported cigarettes made possible by the tariff reduction. We understand that these additional charges will not be imposed. However, a 20 yen per pack surcharge will be levied on all cigarettes, foreign and domestic. Even though this surcharge is not discriminatory, it will have the unfortunate effect of keeping imported cigarettes at a 280 yen per pack price level, rather than permitting them to realize the full price reduction benefit, from 290 to 260 yen per pack, of the tariff reduction. Ambassador Brock had strongly urged the GOJ, therefore, that this surcharge not be imposed. Regrettably, however, the surcharge was passed by th Diet and will be imposed beginning May 1.

The tariff reductions announced also cover roughly $130 million in 1981 U.S. agricultural exports to Japan. However, for the most part, the concessions cover items of only minor export interest, and are not of significant magnitude. The Christmas Day initiative did not contain reductions in the tariffs on many items of interest to the United States, including a wide variety of agricultural products, computers, computer parts and accessories, forest products, alcoholic beverages, farm machinery, and auto parts.

JANUARY 13 INITIATIVES

The January 13 announcement contained several commitments that offer significant potential for increased U.S. access to the Japanese market, in particular the announcement of a high level review of Japan's national certification systems.

REVIEW OF STANDARDS AND CERTIFICATION PRACTICES

A commitment of broad potential value relates to impending revision of Japan's system for approving goods, particularly imported goods. On March 26, 1983, a high level interministerial group of Japanese Government officials recommended that 17 laws be revised to establish the principle of the nondiscriminatory treatment of foreign products during approval procedures. The legislation to effect these changes has been prepared and will be submitted to the Diet before the end of April. The Japanese Government has committed itself to seeking Diet approval of this legislation within the next month. No commitment to revise laws on this scale has ever before been made in the context of United States-Japan trade relations, yet it is only through such revisions that U.S. exporters can be legally guaranteed rights in Japan, similar to those that Japanese exporters already have in the United States. Approximately 60 percent of U.S. manufactured exports to Japan are currently subject to some sort or another of costly and time-consuming "dockside" inspection procedures—a burden that their Japanese competitors do not bear, either in Japan or in the United States. Once Japanese laws are revised, U.S. producers will be given the option of having products and factories inspected and approved before shipment which will significantly ease customs clearance procedures in Japan. This is a major step which, once approved by the Diet and implemented, will mark a complete reversal of past Japanese policy.

The interministerial group also recommended four other measures that address U.S. concerns. They are: increased Japanese participation in international standardization; continued simplification of import procedures; further acceptance of foreign test data; and, greater transparency during the development of standards. We have pressed the Japanese to review their standards practices to incorporate these principles for the past 3 years. Depending on how these suggestions are implemented by various Japanese ministries, in the future, U.S. exporters could have an easier time in having their products approved in Japan.

Although the interministerial group has suggested the adoption of a new motor vehicle approval procedure, it did not recommend the adoption of an approval process for motor vehicles that, for safety requirement, relies on manufactures' self-certification of compliance. That is the system in effect in the United States. We believe that it is no longer a viable policy for Japan to inspect each of the small number (fewer than 4,000 in 1982) of the U.S. cars imported into Japan, while Japanese cars are not inspected by the U.S. Federal Government. To reach this goal, U.S. safety and emission experts have met, and will continue to meet, with Japanese experts.

Despite the unfortunate absence of "self-certification," the impending Diet action is a potentially significant step towards reducing major formal barriers to the Japanese market. Once the changes have been implemented, we intend to take full advantage of the increased market opportunity that should ensue.

TOBACCO PRODUCTS MARKETING AND DISTRIBUTION

The January 13 initiative also contained a decision to increase the pace of the liberalization of retail outlets permitted to carry foreign tobacco products, so that by March 31, 1983, all major cities except Tokyo and Osaka have been included, with outlets in those cities to be included as well by October 31, 1983. Efforts will be made to open all other retail outlets by March 1985, a year earlier than the date of March 31, 1986, announced in the May 28 package. These steps apparently do, therefore, increase the pace of liberalization of access to the retail market for U.S. tobacco proudcts.

The package also promised a study of the possiblity of establishing an independent distribution network for foreign tobacco products. This study is to be linked with the current "administrative reform" analysis of the future status of the Japan Tobacco Monopoly [JTS]. No target date is mentioned for the completion of the study of for eliminating JTS' monopoly over the distribution and marketing of tobacco products, nor is any reference made to the possible elimination of its monopoly over the manufacture of such products in Japan.

CLARIFICATION OF IMPORT RESTRICTIONS ON AGRICULTURAL IMPORTS

The January 13 announcement also noted the decision to clarify import quotas on certain agricultural items, which are of minor export interest to the United States. (For a detailed assessment of these measures, see Attachment B.) The Japanese Government has subsequently informed us that these are minimum import levels. In some cases the GOJ has previously refused to tell us the quota levels. We do know that some of these minimum quota levels are less than actual Japanese imports in previous years. No action was taken to expand import quotas on beef and citrus products, two items of paramount importance to the United States.

The present agreement on beef and citrus expires April 1, 1984. The U.S. objective is to have Japan accept the elimination of its GATT-illegal quotas, and state a specific time by which their elimination will be implemented. The U.S. position was formally given to the Japanese in the first bilateral consultations held under the MTN Agreement last October. The Japanese reply was that this was politically impossible.

During his Tokyo talks, Ambassador Brock said we were willing to resume beef and citrus talks if, if fact, the Japanese wished to do so. Foreign Minister Abe replied that the Japanese Government did wish to resume the talks. Now we shall have to see if that takes us into very specific negotiations or whether the talks will be more general. Because of general elections in Japan, it will probably not be possible to hold these discussions until this summer.

NIPPON TELEGRAPH AND TELEPHONE PROCUREMENT

One further item in the January 13 announcement pertains to procurement by Nippon Telegraph and Telephone Corporation [NTT], regarding which we have an agreement with Japan scheduled to expire at the end of this year. The announcement stated that measures will continue to be taken actively to ensure the participation of foreign companies in NTT procurement activities, in accordance with the provisions of the Government Procurement Code. NTT purchases from U.S. firms under the bilateral agreement signed in 1981 have been very small, to the considerable dissatisfaction of U.S. exporters.

The NTT Agreement is an important element of our trade relationship with Japan. The administration, and Ambassador Brock in particular, have taken a keen interest in the implementation of the Agreement and the experience of U.S. firms in their dealings with NTT.

We are now in the final year of this agreement. In the coming months we must reach a decision whether or not extend the agreement beyond it scheduled December expiration date. The basic factor in our review of the NTT Agreement must be actual sales by U.S. companies. While this agreement does not guarantee sales, it does provide opportunities for our firms to compete. The U.S. telecommunications industry is highly competitive internationally. This, combined with a determined effort on the part of the firms involved, should result in substantial U.S. sales to NTT.

I must report to you that, to date, U.S. sales have not been at the level we anticipated. In 1982, NTT purchased goods from U.S. companies valued at $30.4 million, out of total procurement of about $3 billion. While this is nearly double the level of sales over the previous year, it falls far short of our expectations. Furthermore, NTT has not yet awarded contracts for major high technology products to U.S. companies. Serveral major procurements are pending, and we will await the results with great interest.

During Ambassador Brock's recent visit to Tokyo, he discussed this matter at length with Dr. Shinto, president of NTT. At that time Dr. Shinto described improvements in NTT's purchasing practices designed to facilitate foreign competition. Ambassador Brock welcomed these improvements but stated that the test will be actual sales. While NTT has recently done a commendable job in implementing the administrative aspects of the Agreement, he stressed that there would have to be a marked improvement in U.S. sales for the agreement to be considered successful and to induce us to seek its renewal. We will continue to monitor the results of the NTT Agreement in the coming months. I am hopeful that we will see substantially increased sales and I am encouraged by reports from U.S. firms that they are making progress in their dealings with NTT. However, we must make a realistic assessment of the agreement, based on commercial results, as we approach its scheduled expiration.

HIGH TECHNOLOGY TRADE AND INVESTMENT RELATIONS

The vital area of trade and investment in high technology goods and services has been one in which a good deal of friction has arisen between the United States and Japan. Japan is the only nation with which the United States runs a deficit in high technology trade. The imbalance stems in part from the unequal footing on which U.S. firms have had to compete in Japan. I shall address the reasons for that unequal footing in my comments on industrial policy below, Suffice it here to say that the administration has been engaged in intensive discussions with the Japanese Government on the issue, which have recently borne fruit in the form of a set of recommendations, adopted by both governments, to govern our bilateral trade and investment relations in high technology.

The recommendations, which are attached as Attachment C, were drawn up as the product of intensive discussions over the past year by the United States-Japan High Technology Work Group. The Work Group, which was established in April 1982, is chaired jointly on the U.S. side by the Office of the U.S. Trade Representative and the Department of Commerce and on the Japanese side by the Ministry of International Trade and Industry [MITI].

The Work Group's recommendations, approved by the United States and Japanese Cabinets on February 10, 1983, consist of three major parts:

A set of principles which affirm that markets and opportunities for investment should be kept fully open in high technology fields. The principles commit the two sides to nondiscriminatory treatment of foreign companies and to rectification of distortions to trade arising from government policies.

A set of concrete steps for the immediate alleviation of problems. These include joint collection of market data, beginning with semiconductors, to help anticipate trade problems; development of a plan by Japan to stimulate imports of high technology products; and measures to enable U.S. companies to license more easily technology from Japan and to open Japanese Government funded R&D projects to U.S. companies.

A long-term work program which commits the two sides to studying and making recommendations with regard to government policies and their impact on the health of the high technology industries and trade, especially in semiconductors, computers, and telecommunications.

The Work Group will commence the process of data collection on the semiconductor industry at the beginning of next month. Needless to say, the implementation of the recommendations per se is not an instantaneous solution to the problems between the United States and Japan in the high technology field. However, the recommendations do constitute a new and essential framework within which we shall be able to address those problems and to make progress in bringing about a more equitable basis for competition between United States and Japanese firms, both in the Japanese market and elsewhere around the world where they compete.

As Ambassador Brock noted in his letter to Foreign Minister Abe informing the Japanese of the U.S. Cabinet's adoption of the recommendations, they "stand as clear evidence of the good progress that our two Governments can make through determined efforts to address promising as well as difficult areas in our trade relations." The test of the success of the recommendations will be in the degree to which they are implemented, and the balancing of competitive conditions that ensues.

INDUSTRIAL POLICY AND TARGETING

Mr. Chairman, as I pointed out in my remarks on high technology trade, one of the reasons for the U.S. deficit with Japan in that trade is, we believe, the fact that U.S. firms compete on an unequal footing in Japan. In part that inequality derives from industrial policies practiced by the Japanese Government, the trade restrictive and distortive effects of which the recommendations of the High Technology Work Group have been designed to correct.

Japan's industrial policies are formulated in support of a national strategy of designating particular industries as essential for the development of the economy. The policy tools used by the Japanese Government to foster development of its target industries may afford domestic firms significant competitive advantages in the form of cost and risk subsidization. Government support includes: financial and other assistance for R&D; highly accelerated depreciation; Government-backed leasing corporations; preferential licensing of government-controlled patents; and a near monopoly on procurement. Foreign companies have in the past been virtually excluded from these projects and special grants, even if they have had Japanese subsidiaries.

The results of Japanese targeting have been mixed: successful with telecommunications and steel; less so with aluminum and petrochemicals.

In our discussions with the Japanese Government we have made it clear that Japan's right to maintain industrial policies is a sovereign one in which we have no wish to interfere. But where those policies have the effect of leading to distortions of trade, investment, and international competition between U.S. and Japanese firms, our own policy objectives and national interest require that action be taken.

The Houdaille petition that is presently before USTR seeking relief for the U.S. numerical control machine tool industry, and the recent report of the Semiconductor Industry Association on the effects of government targeting programs on world semi-conductor competition are symptomatic of the groundswell of criticism of the trade distortive effects of industrial policies, especially those of Japan.

Each of the five general trade policy objectives of the United States in its trade relationship with Japan that I enunciated at the outset of this testimony, Mr. Chairman, is affected in one way or another by this issue. We seek access for U.S. participation in the Japanese economy equivalent to that enjoyed by Japanese firms in this market. We recognize the economic reality that the preferences granted by Japanese industrial policies to Japanese firms in their own market and restrictions or impediments placed upon our firms there, put our firms at a significant competitive disadvantage. They will at a minimum be denied the volume and experience economies that flow from an unimpeded opportunity to participate in both of the world's two largest markets for most products.

Secondly, while the United States seeks access for all its products to the Japanese market, access has been more difficult to achieve for manufactured goods (and value-added agricultural products). Japanese Government industrial policies and corporate practices which restrict access to Japan's market for these products thus affect the composition and volume of our trade with Japan, and in part account for the low proportion of manufactured goods among Japan's total imports. Competitive U.S. manufactured good must be allowed to compete with Japanese goods not merely to complement them in areas where Japan does not produce.

Third, in terms of U.S. international competitiveness in industrial sectors of strategic significance to our own, and the world, economy, such as high technology, we must ensure that competition between U.S. firms and Japanese firms is fair competition. We must act to ensure that Japanese and other foreign industrial policies are in accord with international rules of fair play and are so framed that they do not eventuate in competitive disadvantages to the United States in the Japanese and third country markets and do not lead to disruption of competition in the U.S. marketplace.

Fourth, in seeking these objectives, Mr. Chairman, we also seek to maintain our commitment to free trade, to what has been called the "virtuous cycle" of economic progress and technological advancement that has been the real benefit brought to us all by the free trading system. But free trade must flow in both directions if that "virtuous cycle" is not to succumb to the vicious cycle of protectionism. We have emphasized to the Japanese that pressures for protection of U.S. industries affected by Japanese competition are very real and building, and that they are fueled by the perception that Japanese policies, including industrial policies, restrict access to the Japanese market for competitive U.S. products at the same time as they confer significant competitive advantages on Japanese products in this and other market.

Fifth, in the same vein we have striven to impress upon Japan the recognition that policies originally designed to reconstruct a shattered postwar economy and protect struggling new industries have little place in a world where Japanese products are a major force in the marketplaces of her trading partners. Japan is now a leader in world trade; she must shoulder the burdens, and bear the risks, of free trade. The recognition that industrial policies have trade effects must be considered, and balanced, in the formation of those policies.

In part, Mr. Chairman, the Japanese industrial policies of which I have been speaking take the form of targeting new industries as key to future economic development. The U.S. goal in addressing that aspect of Japanese industrial policy is to ensure full access and fair competition. That is also our objective regarding industrial policies designed to assist declining industries in which Japan has become increasingly uncompetitive. We are specifically concerned that the new Japanese legislation to expand the coverage and extend the duration (to a decade) of assistance to depressed industries may restrict access to the Japanese market in a number of sectors where U.S. firms have a competitve advantage.

Such legislation runs counter to the direction of real trade liberalization. Positive adjustment assistance to industries in decline is a laudable objective, but cartels that insulate inefficient domestic competitors from more efficient foreign firms counter both Japan's statements of her commitment to free trade and her overall economic interests.

These are complex and vital issues, Mr. Chairman. We cannot afford to deal with them on a case-by-case basis. That is why during his visit to Japan, Ambassador Brock called upon the Minister of International Trade and Industry, Mr. Yamanaka, to begin with us a dialog on the trade effects of these differences in the ways in which we each manage our economies. I am pleased to be able to say that the Japanese Government has responded positively and cooperatively to Ambassador Brock's call and that we have Minister Yamanaka's agreement to the dialog.

This dialog, if it is to be meaningful, must in our view, Mr. Chairman, contribute in a measurable way to the achievement of the objectives I have outlined above. We shall be seeking input from the Congress, and from the private sector, as we proceed, and as I call for your assistance, let me also offer my assurance that the administration will continue to keep the Congress informed of our progress.

HOUDAILLE PETITION

Let me turn for a moment to a very specific trade dispute concerning the question of Japan's target industry policy. I am referring, of the petition filed by Houdaille Industries, Inc.

The Houdaille petition, which was filed on May 3, 1982, alleges that the Government of Japan has adopted an industry-target policy whereby it has encouraged the development of a cartel in the Japanese numerically controlled [NC] machine tool industry and has provided substantial subsidies to NC machine tool producers, and that the result of this policy has been a rapid surge of Japanese imports since 1975. Petitioners have requested that the President exercise his authority under section 103 of the 1971 Revenue Act to deny the investment tax credit to Japanese NC machining centers and punching machines for a 5-year period.

This case raises many complex factual and legal issues which have been the subject of extensive analysis within the executive branch. It is a precedent-setting case because it marks the first time that the President has been requested to use his authority under section 103 and it is the first time that industry targeting has been the focus of a trade petition. The interagency review process is now nearly completed and a recommendation will be submitted to the President shortly.

U.S. DIRECT INVESTMENT RELATIONS WITH JAPAN

During his trip to Japan, Ambassador Brock put a great deal of emphasis in his talks with Japanese officials on the need for greater two-way direct investment between Japan and the United States.

Direct investment should be fundamental to our trading relationship with Japan. Together we represent the two largest sources of investment capital in the world. Yet, U.S. direct investment in Japan has not been central to our economic relationship. For example, since 1978, the flow of U.S. direct investment to Japan measured only about 3 percent of total new U.S. direct investment abroad. By comparison, since 1978, new U.S. direct investment was five times greater in Canada, five times greater in the U.K., and three times greater in the Netherlands. In all, since 1978, U.S. direct investment was greater in nine other countries than it was in Japan.

With respect to U.S. inward investment, Japan has not been a major foreign investor in the United States, although such investment appears to be growing. The production of Honda vehicles in Ohio, Nissan trucks in Tennessee, and Toyota/General Motors cars in California, are perhaps the best known examples of an upward investment trend. Still, four other countries have invested more heavily in the United States than has Japan. The Japanese investment position in the United States was about $6.9 billion at the end of 1981. On the other hand, the U.S. investment position in Japan was about $6.8 billion at the end of 1981.

I am concerned that foreign direct investment between our two countries has to date not lived up to its potential. While recent trends towards greater two-way investment are encouraging, our two governments should jointly identify all substantial investment barriers, and then explore formal and informal ways of removing them. In this regard, my staff has been working with other agencies to identify the most substantial impediments to U.S. investment in Japan and to determine what steps could be taken to strengthen United States-Japanese investment relations.

One area I am particularly interested in examining is Japan's investment notification process. On the surface, it appears that Japan only places special restrictions on foreign investment in four industries and eleven firms. However, upon closer review, Japan also reserves the right to alter or suspend any planned foreign investment if the investment seriously or adversely affects either the smooth performance of the national economy or Japanese enterprises engaged in a similar line of business. I cannot help but view this as a form of screening which could in the future be employed to exclude U.S. investment in Japan solely on the grounds of competitiveness. Barriers comprised of subjective criteria such as this do not reflect the mature relationship that should exist between our two countries.

If these and other investment-related problems are appropriately addressed, the resulting increases in U.S. investment could perhaps help solve some of our trade problems as well. Such investment could help U.S. firms penetrate Japanese markets—through sales of products manufactured by U.S. affiliates in Japan, through access to Japanese distribution networks for the products of U.S. parent countries, and through the export of U.S. equipment and component parts for assembly in Japan. The potential for U.S. investment to generate increased U.S. trade in Japan, particularly manufactured goods, is there.

In 1977, nearly 40 percent of all U.S. manufactured exports went to U.S. affiliates abroad. Yet, in this same year U.S. manufactured exports to U.S. affiliates in Japan accounted for only 17 percent of total U.S. manufactured exports to Japan. These figures suggest the importance of investment barriers in our overall economic relationship with Japan. However, I believe that by working to improve both trade and investment relations with Japan, we stand to generate benefits which will be mutually reinforcing.

In summary, I would like to say that if investment issues with Japan are not adequately monitored and steps are not taken to increase two-way investment flows between our two countries, we will miss an excellent opportunity over the longer run to indirectly solve some of the pressing bilateral trade issues that are confronting us. For this reason, I have asked my staff to give a high priority to this element of our economic relationship with Japan.

SERVICES

Japan has been a supporter of our GATT initiatives to develop international rules governing trade in services. Former Prime Minister Suzuki was the first foreign head of government to publicly support our call that services trade issues be addressed in the GATT. Throughout the preparations leading up to the GATT Ministerial last fall, the Japanese were very helpful as we were seeking support for our view that services trade should be brought into the GATT framework.

With respect to our bilateral services trade issues, progress with the Japanese has been mixed. It has been a bit more consistent than in other trade areas, however. We have, for example, cleared up a backlog of applications for insurance licenses by U.S. firms that had at times extended over several years. U.S. banks now receive, in most cases, the same treatment as Japanese banks. U.S. shipping companies have shipped, on a trail basis, their first shipments of tobacco to Japan. Legislation is passing through the Diet which would liberalize the telecommunications system in Japan, and open it to meaningful foreign competition.

This is not to say that we do not have bilateral problems with the Japanese in the services trade area. An example is the case of legal services, where U.S. lawyers are not allowed to establish offices in Japan. Bar associations from the two countries have met to discuss possible solutions to the problem, which would require new legislation in Japan, but the outcome is still uncertain.

We have made progress, however, especially considering that in Japan, as in many countries, dealing with services issues requires the involvement of many government agencies and organizations which do not normally deal with trade issues, and are therefore unfamiliar with their complexity.

CONCLUSION

Mr. Chairman, The United States and Japan are at a critically important point in our trading relationship. As you know better than I, the pressures for protectionism, for restricting rather than expanding the scope of the free trading system, have grown from a groundswell into an impending avalanche. These pressures will not recede as the economy turns from recession to expansion. In fact, the U.S. trade deficit worldwide is likely to grow to between $50 and $60 billion in 1983, and at the same time our manufactured goods deficit with Japan is likely to be on the order of $27 billion.

If that fact is not to cause the avalanche to fall, to bury our trading relationship in restrictive and protectionist retaliation, then prompt and decisive action on Japan's part is called for to commit herself to sharing the trade policy objectives I outlined earlier, all of which are in Japan's deepest self-interest, to join in forging the new trade partnership that Ambassador Brock called for on his visit to Japan.

As the Japanese often point out, every crisis is also an opportunity. Japan's new leader, Prime Minister Nakasone, has in his brief tenure so far demonstrated a grasp of that opportunity in the energetic and courageous leadership he has shown in dealing with some of the difficult issues confronting us. Ambassador Brock, in his meetings with the Prime Minister and other Japanese leaders placed utmost importance upon reinforcing the message that together we must either grasp the opportunity, or succumb to the crisis.

ATTACHMENT A

DECEMBER 25, 1982 TARIFF REDUCTIONS AND ELIMINATIONS

The January 13 formal announcement of unilateral tariff measures to be taken by the Japanese Government contains tariff reductions and eliminations on 47 agricultural items, 28 industrial items, 8 manufactured tobacco items, chocolate, and biscuits. Announced preliminarily on Christmas Day, these reductions and eliminations are in addition to the concessions on 215 items announced last May 28 and the concessions on 13 items announced November 16.

The principal concessions of interest to the United States are the cuts on manufactured tobacco products and chocolate. The tariff on cigarettes and cigars will be reduced from 35 percent to 20 percent, with a compound tariff rate introduced for cigarettes, and the tariff on pipe tobacco will be reduced from 60 percent to 35 percent. We estimate that these concessions cover $60 million in 1981 U.S. exports of manufactured tobacco products, and $10 million in chocolate exports. While both domestic industries were seeking elimination of Japan's tariffs, the concessions offered by the Japanese could result in increased export opportunities in the these product areas.

Although the tariff concessions on industrial products cover roughly $180 million in 1981 U.S. exports to Japan, in most instances the depth of cut involved is relatively small. For example, the concessions on paper and paperboard, the most important industrial items in the package from the trade volume standpoint, range from 1-3 percentage points in existing tariffs in the 6- to 12-percent range. Principal industrial items covered include paperboard ($90 million in 1981 U.S. exports to Japan), kraft paper ($50 million), and magnetic tape ($35 million). The announcement also included the elimination of existing tariffs on imported numerically controlled machine tools.

The December 25 initiatives also contain tariff reductions and eliminations on 47 agricultural items. Of these 47 categories, 18 were not on the request list presented to the GOJ by the USG in May 1982. Of the products not requested by the United States, seven are other vegetable oils, seven categories are similar to those already on the list (e.g., dried mangoes was added after fresh mangoes), and the final four categories are chicory, cocoa powder, preserved peaches, and nut shells.

Nearly all of the tariff reductions are accelerations of the final MTN duty levels that were to be reached by April 1, 1987. In 1981, the total value of Japanese imports was $142 million. (The value of the trade included in the May USG request list was $1.075 billion. If beef and citrus are excluded, the value was $751 million). The value of only those items on the U.S. request list is $145 million (of which $15 million was partially addressed in the May 28 package).

Prior to their reduction, these tariffs averaged 14.5 percent and ranged from 1.9 to 33.8 percent. After the reductions, the average tariff will drop to 11.8 percent with a range from free to 30 percent. Based on 1981 trade data, the potential revenue loss to the GOJ is estimated at $7.9 million.

The most recent measures also contain nine items that were added to the Japanese GSP list, including almonds, ripe olives, macadamia nuts, mixed vegetable jucies, and peanut butter. Designation for GSP status will nullify substantially the benefits accruing to U.S. exporters as a result of previous tariff reductions on these items.

The tariff concessions announced by Japan do not include concessions on many of the items on the U.S. request list submitted to the Japanese Government in late 1981 and subsequently updated, including a wide variety of agricultural products, computers, computer parts and accessories, forest products, alcoholic beverages, farm machinery, and auto parts.

ATTACHMENT B

ANALYSIS OF GOJ MEASURES TO INCREASE AGRICULTURAL QUOTAS

On January 13, 1982, the GOJ announced new import levels for six agricultural quota categories. Their action on these six quotas was the same as they had proposed in October and December meetings with USG officials. No action was taken on the beef and citrus quotas.

1. *Beans and Peas.*—The minimum quota for JFY 83-85 is $50 million (110,000 metric tons [MT]) annually. According to the Japanese package, "the actual quota for Fiscal 1979 was 51.5 million dollars, 113,500 MT." In JFY 1980, the quota level was $68.8 million; in JFY 81, $120 million; and in JFY 82 (April-September), $58.8 million.

2. *Peanuts.*—The quota level for JFY 83-85 is 50,000 MT annually. This is a minimum level. Efforts will be made to set up a quota of about 60,000 MT in JFY 1985. The quota was 61,500 MT in JFY 80; 49,800 MT in JFY 81; and 24,900 MT (April-September) in JFY 82.

3. *Fruit Puree and Paste.*—The quota for JFY 83-85 is 3,000 MT annually. In JFY 80, the quota was 4,056 MT. Actual trade in that year was 1,418 MT. This new quota level is one that we requested in the context of considering what would be acceptable for a 1-year moritorium. Liberalization would be preferred.

4. *Tomato Juice.*—The quota is for 3,000 KL in JFY 83. Quota levels have not been disclosed in the past, but the trade in CY 80 was 552 KL; in CY 81, 284 KL; and in CY 82, 183 KL (January-November). If the quota is filled, the GOJ will endeavor to expand it.

5. *Ketchup and Sauce.*—The quota level is 3,000 MT in JFY 83. Again, quota levels have not been disclosed before this. Trade in CY 80 was 1,824 MT; in CY 81, 2,336 MT; and CY 82, 1,590 MT (January-November). If the quota is filled, the GOJ will endeavor to expand it.

6. *Non-citrus Fruit Juices.*—The quota for prune, cranberry, and tropical juices will be a total of 1,000 MT annually for JFY 83-85. Past quota levels have not been disclosed but trade, including pineapple juice, was about 1,380 MT in JFY 72-80. According to the GOJ, actual trade of the three juices was 60 MT in CY 81.

The minimum quota on apple juice for JFY 83-85 will be 1,000 MT annually. The quota level in JFY 80 was 4,000 MT and has been 0 in the past 2 years. According to the Japanese package. "the actual average quota for Fiscal 1979 and 1981 was 1,730 MT".

The minimum quota on grape juice for JFY 83-85 will be 2,500 MT annually. According to the Japanese package, "the actual average quota for Fiscal 1979 and 1981 was 2,300 MT." According to information from the U.S. Embassy in Tokyo, the quota level in JFY 80 was 1,800 MT; in JFY 81, 3,600 MT; and in JFY 82, it is estimated to be 3,600 MT.

In addition, the total quota for the non-citrus fruit juices for JFY 83-85 will be a minimum of 5,000 MT annually. According to the Japanese package, "the actual average quota for Fiscal 1979 and 1981 was 4,300 MT."

ATTACHMENT C

RECOMMENDATIONS OF THE UNITED STATES-JAPAN WORK GROUP ON HIGH TECHNOLOGY INDUSTRIES

Foreword

In the area of high technology industries, industrial structures and trade patterns have been rapidly changing in the course of active technological innovations and development of new products both in the United States and Japan. These conditions may increase the potential for disruption in high technology markets and heighten frictions among trading partners. To resolve current problems, promote understanding and improve prospects for growth in high technology industries, the Work Group has begun by examining pressing issues in bilateral high technology trade, especially in the areas of semiconductors, supercomputers, and fiber optics.

Based on its discussions, and in accordance with its terms of reference, the Group submits the following recommendations to the appropriate authorities of both governments. Nothing in these recommendations shall be construed as limiting or derogating from the international legal rights and obligations of the two countries.

Activities of the Work Group naturally concern industrial and trade matters pertaining to the field of high technology, and nothing contained in the recommendations is intended to prevent either country from taking any action or not disclosing any information which it considers necessary for national defense purposes.

The Work Group recommends that the recommendations contained herein be implemented insofar as is consistent with domestic laws and international legal obligations.

I. PRINCIPLES

The Work Group recommends that each government:

A. Goals and means

Recognize that high technology industries have been growing rapidly and that further expansion of these industries has the potential to open up economic frontiers, assist in the revitalization of the world economy and contribute to the elevation of the quality of life;

Recognize the important role of government in improving the climate for private sector investment and research and also recognize its responsibility to minimize trade distortions and impediments to free and open trade, investment, and technology flows that may result from government actions related to domestic high technology industries; and

Reaffirm the importance of the role of governments in vigorously safeguarding the rules of the marketplace and preventing anti-competitive or predatory practices.

B. Free flow of trade, investment and technology

Undertake to ensure full mutual access to trade and investment opportunities in high technology industries;

Work for the reduction and elimination of such impediments and distortions as may exist in high technology trade;

Seek to ensure that opportunities to participate in each other's markets will be substantially equivalent. (With positive action on the part of the private sector and government, increased opportunities can be expected to lead to increasing participation in each other's markets which should be possible to assess);

Undertake to ensure that policies do not directly or indirectly discourage or impede government or private procurement of foreign high technology products or services, or bilateral transfers of technology;

With the view of promoting free, fair, and open competition in high technology, undertake to provide that programs which provide particular advantages to enterprises in specific high technology industries will be open to enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

C. International cooperation

Affirm the significance of exploring appropriate ways in which cooperative efforts, including cooperative R&D and technology exchange consistent with anti-trust laws and policies, could promote high technology industries;

Undertake to ensure that participation in government sponsored R&D projects will be open, in principle, to enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

II. IMPLEMENTATION

A. Market access and trade promotion

1. Joint Data Collection.—The Work Group recommends that for a full assessment of the factors affecting bilateral high technology trade, the Work Group establish with the cooperation of private sector sources in both countries, a Joint High Technology Data Collection Task Force. The Task Force would begin with semiconductor data collection in the following manner:

Decide on the coverage, classification and methods of data collection, taking into account the usefulness and availability of the data.

Gather data on bookings and billings for the U.S. and Japanese markets.

Gather additional useful production and trade data.

Develop methods for eliminating statistical distortions such as those resulting from different treatment of value added in countries other than the United States and Japan.

These activities should be conducted in a manner consistent with each side's antitrust or anti-monopoly laws and policies. The Task Force will begin collection of data, including bookings and billings, as of March 1, 1983 and make its first report to the Work Group on the data collected in early April, 1983. The Task Force will report on its progress at each meeting of the Work Gorup. Under the guidance of the Work Group, the Task Force will consider similar data collection in other high technology sectors.

2. Solving Trade Problems.—The Work Group recommends that: Problems of access, if any, especially as they relate to procurement and distribution, be discussed and solutions sought in the Work Group. If both sides agree, the Work Group will, as appropriate, take steps to have relevant agencies or independent organizations investigate and solve the problem. Note: Each side is, of course, free to take independent action.

Each government include enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country in its programs, and encourage inclusion of such enterprises in private programs, to promote sales or provide other economic benefits in the field of high technology industries.

Each government take steps to eliminate the use of such specifications as may exist which arbitrarily discriminate against enterprises owned or controlled, directly or indirectly, by nationals of the other country in the procurement of high technology products by government entities and encourage the elimination of such specifications by private sector organizations. Any technical specifications prescribed by government procurement entities should, where appropriate, be in terms of performance rather than design. Taking into account the views and activities of the Work Group, among other, each government should explore issues related to the appropriateness of technical specifications prescribed by government entities.

The Government of Japan develop possible concrete measures to promote imports of manufactured goods in high technology in light of the Prime Minister's May 28 statement, taking into account the views and activities of the Work Group.

B. Information exchange, technology transfer and international cooperation

The Work Group recommends that:

1. Channel for R&D Information.—The governments create a government-to-government channel to facilitate the timely exchange of information on upcoming government sponsored R&D projects, and to provide information on ongoing projects including methods of access and technology rights.

2. Information Windows for Patents/Technology.—Each government establish information windows to answer private sector inquiries concerning patent and technology exchange, including, where practicable, catalogue of patents, procedures for gaining access to patents, and procedures for licensing technology.

3. Data Exchange.—Each government establish meausres and institute proceedings to ensure a balanced mutual flow of technical information through appropriate public and private organizations, and make available technical reports on current government sponsored programs at least annually.

4. Access to Programs.—Each government ensure that government sponsored R & D programs will be open, in principle, for participation by enterprises constituted under the laws and regulations of the one country and owned or controlled, directly or indirectly, by nationals or companies of the other country, on the same basis as for enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country.

5. International Cooperation in R&D.—Each government make further efforts to promote cooperation in R&D in the technology fields which are suitable for international cooperation.

6. Access to Technology.—Each government undertake to facilitate licensing of patents and technology held by the government in blocks and families rather than item by item, to enterprises owned or controlled, directly or indirectly, by nationals of the other country, on the same basis as to enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country. Each government also undertake to limit government intervention in the licensing of privately held technology.

7. Investment.—Each government undertake to ensure that plans calling for the development or rationalization of a high technology industry are drawn so that all enterprises constituted under the laws and regulations of the one country, (whether owned or controlled, directly or indirectly, by nationals or companies of the one country or of the other country) participating in such an industry, are treated equally in terms of the opportunity for inclusion. Each government also undertake to ensure that enterprises constituted under the laws and regulations of the one country, and owned or controlled, directly or indirectly, by nationals or companies of the other country, are treated on the same basis as enterprises constituted under the laws and regulations of the one country and owned or controlled by nationals of that country in access to investment promotion programs, including depressed area funds, concessionary lending, etc.

8. Facilitating Cooperative R&D.—The U.S. government review the impact of U.S. antitrust law on the ability of U.S. enterprises to participate in cooperative R&D programs, and make appropriate recommendations.

C. Competitive Practices

1. Accounting Analysis.—The Work Group recommends that by the end of March 1983, will bring together fnancial staff from high technology firms to examine U.S. and Japanese accounting methods in high technology industries.

III. GENERAL

The Work Group will:

1. Report on Market Development and Trade.—Using the joint data collection developed under Section II A.1. above, issue regular reports on market trends for high technology products in the U.S. and Japan and technology flows between the two countries.

2. Invite Private Sector Participation.—Invite private sector advisors and industry representatives to participate in subcommittees of the Work Group, particularly in the consideration and development of individual sector reports, and in the review of trade distortions and conditions in specific high technology markets.

IV. LONG TERM WORK PROGRAM

The work Group will undertake a long term work program, according to the attached outline.

V. ADOPTION

The Work Group recommends that the two governments Act on these recommendations, after necessary internal procedure not later than the end of January 1983.

OUTLINE FOR LONG-TERM WORK PROGRAM

A. Sectoral analysis

If agreed by both sides in the Work Group, the Work Group will conduct sectoral analyses with the objective of identifying and resolving sources of trade friction and of promoting industrial cooperation between the two countries.

The first sectoral analysis, a study of the semiconductor industry, will be initiated as of February 1, 1983.

Other sectors to be analyzed will be decided by agreement of both sides in the Work Group. Once a sectoral analysis has been agreed upon, the Work Group will agree on a timetable appropriate to the sector.

Upon completion of a sectoral analysis, it will be reviewed by the Work Group for not more than thirty days. The Work Group will then develop joint recommendations for resolving problems in the sector by its next meeting.

B. Research associations and organizations

The Work Group will undertake a joint case study of the organization, management, and decision-making process (including the handling of patent/technology, the decision to launch new projects, etc.) in a specific research asssociation or organization.

C. Industrial cooperation in high technology

The Work Group will examine the nature of industrial cooperation agreements between the U.S. and Japan and between the U.S. and third countries and between Japan and third countries.

D. Other issues

Other issues, including patent rights and import promotion measures, will be addressed at the agreement of the two sides in the Work Group.

Mr. SMITH. Mr. Chairman, I am also accompanied by Mr. James Murphy, Assistant U.S. Trade Representative for European and Japanese Affairs, and by Ms. Jeanne Archibald from the Office of the General Counsel of USTR.

Mr. Chairman, with regard to U.S. trade policy vis-a-vis Japan, the fundamental goals are to further the development of the U.S. economy and the economic well-being of Americans and to maintain and strengthen the international free trading system.

To realize these goals in its trade relationships with Japan, U.S. trade policy has five general objectives.

First, obtaining overall access for U.S. participation in the Japanese economy in goods, services, and investment on a basis equivalent to that enjoyed by Japan in the U.S. market.

Second, insuring trade composition and volume which reflect U.S. competitiveness.

Third, insuring fair competition between United States and Japanese firms in the United States, Japanese, and third country markets, and eliminating distortive or disruptive effects that may arise from Japanese Government industrial policies or corporate practices.

Fourth, avoiding protectionist measures; and

Fifth, inducing Japanese leadership in free trade commensurate with Japanese economic strength and Japan's stake in the system.

With regard to current status of United States-Japan trade issues and negotiations, I think it is fair to say United States-Japan trade relations are currently characterized by increasing friction as a result of the continued presence of barriers preventing access for foreign goods, services, and investment to the Japanese economy, and exacerbated by the expanding bilateral trade surplus in favor of Japan—$17 billion in 1982, and projected at $20 to $22 billion in 1983.

The fundamental issue central to most current bilateral trade problems with Japan is the lack of access for U.S. goods, services, and investment to the Japanese market, equivalent to that enjoyed by Japan in the U.S. market.

The administration has concentrated on increasing U.S. market access in Japan through intensive bilateral negotiations over the past 18 months.

A commitment of broad potential value relates to impending revision of Japan's system for approving goods, particularly imported goods.

On March 26, 1983, a high level interministerial group of Japanese Government officials recommended that 17 laws be revised to establish the principle of the nondiscriminatory treatment of foreign products during approval procedures.

The legislation to effect these changes has been prepared and will be submitted to the Diet before the end of April. The Japanese Government has committed itself to seeking Diet approval of this within the next month. No commitment to revise laws on this scale has ever before been made in the context of United States-Japan trade relations.

Yet it is only through such revisions that U.S. exporters can be legally guaranteed rights in Japan, similar to those that Japanese exporters already have in the United States.

Although the interministerial group has suggested the adoption of a new motor vehicle approval procedure, it did not recommend the adoption of an approval process for motor vehicles that, for safety requirements, relies on manufacturers' self-certification of compliance. That is the system in effect in the United States.

We believe that it is no longer a viable policy for Japan to inspect each of the small number—fewer than 4,000 in 1982—of the U.S. cars imported into Japan, while Japanese cars are not inspected by the U.S. Federal Government. To reach this goal, U.S. safety and emission experts have met, and will continue to meet, with Japanese experts.

Despite the unfortunate absence of self-certification, the impending Diet action is a potentially significant step toward reducing major formal barriers to the Japanese market.

Once the changes have been implemented, we intend to take full advantage of the increased market opportunity that should ensue.

During Ambassador Brock's recent visit to Tokyo, he discussed this matter at length with Dr. Shinto, president of NTT. At that time, Dr. Shinto described improvements in NTT's purchasing practices designed to facilitate foreign competition.

Ambassador Brock welcomed these improvements but stated that the test will be actual sales. While NTT has recently done a commendable job in implementing the administrative aspects of the agreement, he stressed that there would have to be a marked improvement in U.S. sales for the agreement to be considered successful and to induce us to seek its renewal.

Agriculture. The present agreement on beef and citrus expires April 1, 1984. The use objective is to have Japan accept the elimination of its GATT illegal quotas and state a specific time by which their elimination will be implemented.

The American position was formally given to the Japanese in the first bilateral consultations held under the MTN agreement last October. This afternoon the United States and Japan will resume these consultations here in Washington in cooperation with the Department of Agriculture.

Mr. Chairman, the effect of foreign industrial policies on U.S. firms is a topic of growing concern within the administration and the Congress. Japan's industrial policies are formulated in support of a national strategy designating particular industries as essential for the development of the economy. The policy tools used by the Japanese Government to foster development of its target industries may afford domestic firms significant competitive advantages in the form of cost and risk subsidization.

Government support includes financial and other assistance for R&D highly accelerated depreciation, Government-backed leasing corporations, preferential licensing of Government-controlled patents, and a near monopoly on procurement. Foreign companies have in the past been virtually excluded from these projects and special grants even if they have Japanese subsidiaries.

The results of Japanese targeting have been mixed, successful with telecommunications and steel, less so with aluminum and petrochemicals.

In our discussions with the Japanese Government we have made it clear that Japan's right to maintain industrial policies is a sovereign one in which we have no wish to interfere. But where these policies have the effect of leading to distortions of trade, investment, and international competition between the United States and Japanese firms, our own policy objectives and national interests require that action be taken.

I would like to speak briefly for a moment regarding the Houdaille case which has figured prominently in United States-Japanese relations for a number of months.

Last May, Houdaille Industries requested that the President to exercise his authority under section 103 of the 1971 Revenue Act to deny the 10-percent investment tax credit to U.S. taxpayers who purchased certain numerically controlled machine tools.

As you are aware, last Friday the President decided not to grant the relief which had been requested by the petitioners.

The President's decision should not be interpreted in any way as condoning Japanese policies as they affect the machine tool industry.

On the contrary, in recognition of the fact that such policies may, in fact, adversely affect U.S. trade interests, the Office of the U.S. Trade Representative will begin consultations with the Government of Japan on these practices.

I want to emphasize that the President is not precluded from taking action pursuant to other statutory authority he deems appropriate.

I would note that the Japanese Government is fully aware of the importance we attach to dealing with this issue particularly and is fully committed to holding these consultations immediately.

This discussion will be an important part of the more comprehensive dialog that we are beginning with Japan on industrial policy issues. In this connection I want to mention that Ambassador Brock will be meeting with Minister Yamanaka of MITI on Thursday in Brussels to establish the framework for exploring those aspects of Japan's industrial policies which we believe have an impact on trade. I will chair the U.S. side in this effort at the subministerial level at our first meeting with the Japanese at that level will be held in mid-May in Tokyo.

As I noted in my testimony to this subcommittee regarding the adequacy of existing trade laws, the administration is closely studying the question of industrial targeting. This dialog with the Japanese that I alluded to earlier will be very helpful in clarifying the elements of industrial targeting policies which affect U.S. interests.

We would like to work closely with this subcommittee during the course of this dialog. Indeed, we will be in contact with the subcommittee staff to discuss the progress of our work with the Government of Japan and to exchange views on any implications that work may have for revisions of U.S. trade law.

I would like to take advantage of this opportunity, Mr. Chairman, to say that I share your strong concern with the trade effects of some industrial policies. Where such policies distort trade or investment flows or confer advantages on others which are not consistent with U.S. law or with international agreements we intend to take appropriate action.

However, we have to bear in mind that the effects of industrial policy can differ widely, that they may not be comparable to the effects of subsidies and that counter subsidy action may not be the most effective response.

For example, if a nation closes its market at some critical stage in the development of a new product, as to say prior to launching an export drive, treating the action as if it were a subsidy is not likely to be affected beyond the problem of trying to quantify the effects of industrial policies as more fundamental issues.

Are we underestimating the significance of industrial policy for trade if we attempt to deal with it as a straightforward subsidy?

The dialog we are now beginning with Japan should be very helpful in answering this question. It is important to recall that the U.S. countervailing duty law was designated to be consistent with the MTN subsidies code. The unilateral revision of the definition we applied to subsidies would likely put us in violation of the code and lead others to redefine subsidies in ways that are contrary to our interests.

This could lead to a breakdown in the only internationally accepted antisubsidy agreement.

As a general proposition, it is clear that we need more precise information about industrial policies and that with this information in hand we must decide which policies may be harmful to U.S. interests.

On the basis of our assessment we can conclude whether any changes are necessary in U.S. trade law to deal with the effects of industrial targeting.

While this process is underway we have sufficient authority under section 301 to deal with short-term problems.

Mr. Chairman, the United States and Japan are at a critically important point in our trading relationship. As you know better than I, pressures for protectionism are restricting rather than expanding the scope of the free trading system, have grown from a ground swell into an impending avalanche.

These pressures will not recede as the economy turns from recession to expansion. Roughly half the total U.S. trade deficit worldwide of between $50 to $60 billion in 1983 will derive from our deficit in manufactured goods with Japan as will all of our current account deficit.

If that fact is not to cause the avalanche to fall, to bury our trading relationship in restrictive and protectionist retaliation, then prompt and decisive action on Japan's part is called for to commit herself to sharing the trade policy objectives I outlined earlier. All of the objectives are in Japan's deepest self-interest, and will join in forging the new trade partnership that Ambassador Brock called for in his recent visit to Japan.

Thank you, Mr. Chairman. I would be happy to answer any questions you may have.

Chairman **Gibbons**. Let's go to Mr. Lamb next, Deputy Assistant Secretary of State for Trade and Commercial Affairs, and then we will come back and talk with both of you.

STATEMENT OF DENIS LAMB, DEPUTY ASSISTANT SECRETARY OF STATE FOR TRADE AND COMMERCIAL AFFAIRS, ACCOMPANIED BY J. SCOTT MONIER, OFFICE OF TRADE; PRESENTING STATEMENT OF ELINOR G. CONSTABLE; DEPUTY ASSISTANT SECRETARY OF STATE FOR FINANCE AND DEVELOPMENT

Mr. **Lamb**. Thank you, Mr. Chairman.

I am particularly pleased to be here today. It is my first appearance before the subcommittee since returning from Brussels about a year ago to take on my present responsibilities. We have submitted a statement for the record.

I would just like to make a very few points before we go to your questions.

Japan, as the subcommittee is well aware, is our principal ally in Asia. Both we and the Japanese have major security and political interests in our relationship. That does not mean that our view in the State Department is that in any way trade issues should be subordinated to these security and political interests.

Rather, it is the reverse. It is going to be our success in managing trade which will preserve and strengthen our basic security and political interests. Our overall objective as I would state it is as follows:

We in the administration want to be sure that trade levels and composition of our trade with Japan reflect true comparative advantage and we are concerned that that is not now the case, and that we must move rapidly to insure that it is.

Ambassador Smith has indicated the main points of our approach—our objectives in trying to resolve trade frictions. To encourage the Japanese:

One, to take a larger role in the management of the international system in keeping with their growing stake in it;

Two, to open their markets to imports as rapidly as possible;

Three, to avoid protectionist measures and;

Four, to conduct their industrial policies in ways that avoid trade distortions.

We have seen progress in the relationship, particularly over the last 15 months, though I wouldn't argue that it has been adequate. It, in fact, has not been adequate and we need to push ahead.

The Japanese system and their approach can be flexible. Their industrial policy, for example, has adapted rapidly during the postwar period. Our message to the Japanese Government is that it has to continue to adapt to Japan's stake in the system and to respond to the irritants that have arisen in the bilateral relationship.

I agree wholeheartedly with what Ambassador Smith has said about our approach and we and STR are cooperating closely on a combined effort to remove the frictions that are troubling this very important relationship.

Thank you, sir.

[The prepared statement follows:]

STATEMENT OF ELINOR G. CONSTABLE, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL FINANCE AND DEVELOPMENT, DEPARTMENT OF STATE

Thank you, Mr. Chairman, I am pleased to have this opportunity to address the issues of United States-Japan trade relations. Our bilateral relationship is critical to our foreign policy and national interest; our trade problems with that country are a key pressure point on our trade policy. It is therefore imperative that we give a high priority to managing the trade problems that have been vexing that relationship.

The United States-Japan relationship is a keystone for peace and prosperity in the Pacific region. Japan is our principal ally in Asia. It serves not only as an outpost for U.S. forces, but as a major contributor to the defense of the region itself. At the urging of the United States, Japan has recently assumed greater responsibilities for defense in the northern Pacific and Prime Minister Nakasone has committed Japan to increase defense spending and to strengthen its defense forces. Furthermore, Japan is the major donor of economic assistance to the region.

The intensity of the economic relationship betwen the United States and Japan has often been pointed out. I need not go into details here, but I would like to reiterate a few facts to point out the importance of the relationship: trade between our two countries reached $58 billion last year—a volume exceeded only by our trade with Canada. Japan buys a tenth of all our exports and supplies almost 15 percent of the goods we import. Japan is our largest market—more than $6 billion—for agricultural products and is heavily dependent on United States farm products. More cropland is planted in the United States for Japan than in Japan itself.

Investment is becoming more important although it has not historically been central to the economic relationship between the United States and Japan. Since the Japanese changed their investment laws in 1979, United States firms have begun to look more seriously at investment in Japan as a means of gaining better access to the Japanese market. Japanese firms have begun to broaden their view of the international market beyond exporting to include investment in production facilities. The actual levels of direct investment between the United States and Japan are small—U.S. investments in Japan reached about $6.8 billion in 1981 and Japanese investment here was about the same, $6.8 billion—but this area of our economic relationship seems likely to be more active in both directions in coming years.

Any two countries with such a broad and close economic relationship are bound to find frictions in that relationship—especially when they are the two largest markets in the world. The spectacular success of Japanese exporters in certain sectors of the U.S. market has generated serious concern here. A bilateral trade deficit of $17 billion with Japan in 1982 while unemployment in the United States is at record levels has exacerbated the concern. Japanese success here stands in sharp contrast to problems many U.S. firms encounter in selling to Japan. This contrast fuels protectionist pressures and has led in the past year to proposals like local content legislation that could close large segments of the U.S. market to Japanese firms.

The frictions generated by Japan's conspicuous export success and the difficulties many U.S. firms encounter in trying to sell in Japanese markets have made Japan a central issue of our trade policy for some time. The objective of our trade policy toward Japan is not to balance accounts. Bilaterally balanced trade with any country is not, nor has it even been, an objective of U.S. policy. Japan's economic structure, not its trade policy, is the main factor leading to its trade surpluses with the United States and Europe. The main factor explaining Japan's surplus in trade with the United States is its dependence on imported raw materials and energy which can only be paid for by exports of manufactures. And we are one of the main markets for those manufactures.

Although Japan's trade policies are not the cause of or answer to the bilateral trade imbalance, they are a major source of trade friction. Quantitative restrictions on U.S. agricultural exports, standards and certification procedures that discriminate against imports and the trade aspects of industrial policies have all created problems. Our trade efforts must be aimed at resolving these problems so that we can preserve and strengthen the vital economic and security relationships between the United States and Japan. In the bilateral Economic Subcabinet consultations that take place semiannually, the Trade Subcommittee of the subcabinet and other bodies, we have the mechanisms for regular discussions of the whole range of trade and economic issues.

Ambassador Brock has cited five basic objectives that guide this administration's efforts to redress the problems that are troubling the United States-Japan trade relationship. Through the joint pursuit of these objectives with the government of Japan, I believe we can resolve the problems troubling us now and strengthen our focus on the long lasting benefits of our bilateral economic relationship.

Let me, if I may, elaborate some on these objectives: First, we look to Japan to join us in our efforts to fight protectionism, by assuming a leadership role in maintaining and strengthening an open international trading system. While it was rebuilding an economy shattered by war and desperately short of capital, Japan, like the countries of Western Europe, was forced to resort to trade restrictions and capital controls. To accumulate capital and sustain growth, Japan looked to foreign markets for opportunities to export. Imports were limited to essentials, not so much to protect domestic industries as to conserve scarce foreign exchange.

This outlook was natural for the fragile Japanese economy of the late 1940's and early 1950's. Japan was heavily dependent on the open world trading system evolving under the newly created GATT, but not yet prepared to take on all its responsibilities.

But Japan's efforts were sucessful, dramatically so. Its economy has grown rapidly to where it is now the third largest in the free world after the United States and the European Community. It has also proven to be one of the most robust. In recent periods of economic downturn Japan has fared better than others. While the U.S. economy showed a decline of 1.7 percent and European countries were stagnating, Japan grew at 3 percent. While unemployment reached double digit levels in the United States and record levels in Europe. It was only 2.5 percent in Japan (perhaps double that if adjusted to U.S. statistical methods).

Japan's postwar development is an admirable economic success story. In part as a result of that success, Japan has tended to cling stubbornly to the policies and business practices of the late 1940's and 1950's. But today these views are inconsistent with an open trading systems. We look to Japan to revise them as it continues the liberalization of its economy.

No country has benefited more from the free and open international trading system than Japan. As the primary target of the current wave of protectionist pressures, no country stands to lose more should the protectionists begin to dismantle the international trading system. We have continually stressed in our dialog that Japan should take a more active role in promoting the free trade system in its own interest.

Japan has long been active in the international bodies governing the free trade system, but largely as a silent partner. We expect it to take a more active role, not only in defending its own interests, but also in promoting further evolution of the system in terms of lowering barriers further and extending existing rules to encompass trade in services and investment.

More importantly, Japan should redouble its efforts at home. The difficulty of penetrating the Japanese market has begun to give some protectionist arguments a respectable face. Japan is in a unique position to promote an international free trade system through domestic policies.

This brings me to the second component in our policy: to seek better access to Japanese markets for U.S. goods, services and investment. U.S. exporters should have access to the Japanese market no less favorable than that enjoyed by Japanese firms here.

The Japanese point out that their average tariff rates are no higher and in some cases less than those of other industrial countries, nor do they keep more goods under quantitative restrictions. Investment is not subject to greater control than in many other countries. By these simple measures, the Japanese market is open.

But to the U.S. exporter or investor, the perception is different. Government policies and corporate practices often reflect an economic nationalism that is a formidable trade barrier. Industrial and agricultural raw materials have easy access, but value-added products are less welcome. Tariffs are highest in those areas where foreign firms are most competitive; quotas appear for agricultural products; standards and certification procedures have often become complex and discriminated against foreign manufacturers.

Thus U.S. tobacco is a major component of all Japanese cigarettes, but U.S.-made cigarattes face high tariffs and must sell through a state-run monopoly that is their chief competitor. U.S. feedgrains are welcome, but beef and citrus products are subject to strict quotas. U.S. logs are eagerly sought by the Japanese and subject to no tariffs, but finished lumber and panel products like plywood face stiff tariffs as high as 20 percent.

Japanese standards and certification procedures have been a particularly irritating problem. It is difficult to maintain support for free trade policies in the face of the spectacle of rigorous "on the docks" inspections of U.S. products in Japan while Japanese cars roll off the ships into the United States on the basis of the manufacturers self-certification that they comply with U.S. standards. During his January visit to the United States, Prime Minister Nakasone undertook to improve its procedures: the review of standards and certification procedures just completed is a welcome step toward bringing Japan into compliance with the GATT Standards Code.

Since it assumed office, this administration had sought prompt action by the Japanese to open their markets to foreign goods. In the past 15 months we have seen the beginnings of a process of liberalization of the Japanese market. The Suzuki government announced packages of trade liberalization measures in December 1981 and May 1982. These packages addressed some tariff problems, customs and import procedures and certain standards issues.

These measures were welcome as a sign the Government of Japan was moving in the right direction but much remains to be done. We have followed the implementation of these measures closely. A particularly important development was the personal commitment of Prime Minister Suzuki in his May 1982 statement to opening Japanese markets and his later encouragement of Japanese industry and the Japanese people to be more receptive to foreign products.

Prime Minister Nakasone has reaffirmed this commitment and has personnally made resolution of the trade problems with the United States a top priority issue for his government. In the few weeks of his administration prior to his January visit here, the Prime Minister made a major effort to take further steps to open the Japanese market, including some tariff reductions on certain items of importance to the United States, strengthening of the Office of the Trade Ombudsman, and launching a review of Japanese standards and certification procedures.

The review of standards and certification procedures is especially significant. The recommendations of the review for the modification of Japanese laws and regulations to accord foreign producers treatment no less favorable the Japanese, and to bring Japan into compliance with the obligations it has undertaken in the GATT Standards Code, will be an important step in opening the Japanese market. We hope the Diet moves rapidly to enact the changes in its current session and that the Government implements them fully and effectively.

Our approach is based on the understanding that what U.S. firms want and need is a chance to compete, a chance to compete on equal terms in the Japanese market. Given that chance, I am confident that the bilateral trade picture will brighten considerably. Of course, there will still be many complaints about Japanese trade especially where Japanese products are conspicuously successful and even continued opening of Japanese markets will not eliminate the deficit. That is not our objective. We only seek a trade regime that is fair.

As we cope with our bilateral trade problems, we must bear in mind another keystone of our policy: to avoid the politically easy but economically devastating route of protectionism. Since the time of Adam Smith we have known that the freest possible play of market forces is necessary for economies to grow prosperous and to provide the new opportunities needed to adjust to international competition. We can erect trade barriers that may temporarily shield a part of the economy or a segment of society, but the vitality of the economy as a whole suffers. Resources are diverted from their best uses, inefficiency and inflation are encouraged by the absence of competition and the protected industry, shielded from market forces, becomes still less competitive and needs still more protection.

We all acknowledge the hazards of protectionist responses but we need to remind ourselves of how real those hazards are. Experience has shown how difficult it is to contain their use. Protection for one group pressured by import competition breeds demands from others for similar protection and retaliation or imitation among our trading partners. Fifty-some years ago nationalist responses to economic difficulties gave us a wave of protectionist measures that helped lock the world in a decade-long depression. The Smoot-Hawley tariffs, that averaged over 50 percent, and the waves of competitive currency devaluation of the same period were instrumental in creating the Great Depression.

At the end of the Second World War the GATT was created to help us develop a free trade regime and to avoid similar rounds of beggar-thy-neighbor policies in the future. The GATT system has had unprecedented success in expanding international trade and promoting economic growth. We should not risk undermining it with politically expedient solutions to our bilateral trade problems with Japan.

In arguing against protection, I do not want to leave the impression here that we are indifferent to the real problems experienced by U.S. workers and industries that experience sudden increases in imports. U.S. laws provide ways for these industries to seek help while they adjust or while the government seeks elimination of the unfair trade practice. Some protection may be appropriate in specific cases, but it should be consistent with GATT rules and should not be used to overcome fundamental market forces.

There is also growing concern about the ability to compete with Japanese firms in the United States and third-country markets. Not that U.S. firms doubt their ability to produce a competitive product at a competitive price. They know they can. The concern is that their Japanese competitors are benefitting from advantages produced not by market forces, but by Japanese Government industrial policies. A fourth keystone of our policy is to eliminate market-distorting or disruptive effects of industrial policies.

Clearly, we cannot dictate to Japan its internal economic organization, but we can expect Japan to formulate such policies with its commitment to free trade in mind. Japan should ensure that policies designed to foster economic growth have not become policies of economic nationalism. As a beginning we are seeking a dialogue with the Japanese Government on its industrial policies. Better understanding of the features of such policies and greater sensitivity to its trade implications should make it possible to eliminate the effects of industrial policies that distort market forces and competition between US and Japanese firms.

The final point of our fivefold path can be understood as a test of the success we have in other areas. We would like to see trade between the US and Japan evolve to reflect better the competitive structure between two advanced industrial economies. Japanese imports have tended to be disportionately dominated by products that are simply not produced there. Partly as a result of the barriers we have been discussing, Japanese-made products often face little foreign competition in their home market. The development of trade along lines that increased competition in the Japanese market would be beneficial to Japan. Consumers would benefit from a reduction of some of the highest price levels in the world. Industry would benefit by added incentives for innovation and efficiency. Finally, tangible evidence that the Japanese market was becoming truly open would help restore our confidence that a free trade system can be maintained.

Chairman **Gibbons**. Thank you, sir. Your entire statement will be included in the record.

Mr. **Frenzel**. Mr. Chairman, is the Lamb statement the same thing as the Constable statement?

Mr. **Lamb**. Yes, sir.

Chairman **Gibbons**. Thank you for clarifying that point, Mr. Frenzel.

Let me make a couple of opening remarks before we go into questioning.

I think overall the United States-Japanese relationship is improving in basics. When I look at my work schedule in perspective, I guess as a Congressman I spend about 60 percent of my time on trade.

Of that 60 percent of my time, Japan takes another 60 percent of my time. That may just be coincidental. One reason for holding these hearings was not to single out or target the Japanese economic system or the Japanese Government or the Japanese people for any particular attention, but I thought if we could understand the [illegible] of friction between the Government of Japan and the Government of the United States and in the industrial systems of the two countries we had a better chance of understanding the whole picture of trade, because this seems to be where the area of major friction is now.

Now, that doesn't mean that we don't have a lot of problems with the European Community and their agricultural policy and dumping and some of the other things. That doesn't mean we don't have a lot of problems with lesser developed nations.

That doesn't mean we don't have a whole host of series of problems, but I sought to try to concentrate our attention on one particular area, so perhaps we could grasp what was going on and understand it better.

Every time I go to Japan I get a deeper respect and a greater understanding for the hard-working, industrious people that the Japanese are. I am trying to understand their point of view and I am trying to understand the point of view of our American business community.

It seemed to me that there are some things that we can agree on. One is that we believe in an open, free trading system, at least I do as one American, and every Japanese I have ever talked to has told me that he does also.

None of us believe in subsidies. We have all agreed not to subsidize. We have all agreed in the General Agreement on Tariffs and Trade and we have all agreed that the subsidies agreement not to subsidize and yet we all do.

We do, the Japanese do and the rest of the world does. We have either got to change our agreement, which I don't think would be wise, or we have got to start enforcing the agreement.

I get letters and phone calls and visits. The most constant single legitimate complaint I get is that we are having to put up with subsidized competition.

Not just the Japanese, but the Mexicans, the Brazilians, the Europeans, and others as well. It seems to be the one thing that everybody can agree on. I have no illusions that we can reform the world just by taking a sufficient stand on subsidies, but it does seem to me that as you look further down the road, unless we put an end to these subsidy practices we are going to get into worse shape than we were in the 1930's where we had extremely high ad valorem tariffs and that these can be much more sources of friction in the type of area that the State Department would worry about than any other tariff barriers we have ever had.

They are going to bring nations face to face with each other in very violent ways, promoting products. And so, I think we have to put an end to it.

We raised the question of industrial targeting and policy with the Japanese. I am convinced they don't really believe they are subsidizing except to a minor amount.

But as I look upon some of their industrial policy, it is a very sophisticated form of subsidy. I don't mean sinister or sneaky. They do it all open and above board and they have got a right to do it as Ambassador Smith pointed out, but when it impacts upon our markets, then I think their right has to be subservient to our rights.

Now, we haven't got a very good record of enforcing our rights of American people against the subsidies for American producers against the subsidies. At least we haven't in the past.

Now, it appears to be improving but the constant complaint is that it takes too long, costs too much and when we get to the end of the road, like in the Houdaille case, the President decides for some other reason that we shouldn't enforce the law. That breeds nothing but cynicism, not on the part of the lawmakers but on the part of American industrial community that has sought to protect itself under the laws that the Government gave it to work under.

That is the problem. We are undermining not only our domestic economy by not enforcing our laws, but we are undermining the whole basis of law.

Now, that has been a long soliloquy that I have gone on with, but I hope you all understand what I am driving at. I am interested in expanding free trade, the whole concept of it, but subsidized trade is not free trade, and it ought to be dealt with very vigorously. If the shoe binds on us, it ought to bind on us just as well as it should on the Japanese.

We ought to cut it out, but unless we do it, it is just going to be a disaster. In light of that, what about the Houdaille case? What is going to happen next? Does anybody in the audience want to say anything, any of the Members, any of the press?

Mr. PEASE. The witnesses are fighting over who will answer.

Mr. SHULZE. Mr. Chairman, I might say that I agree with what you said that if we don't do something or if this is not remedied in some way, there is a rising political tide in this country which is going to force something to be done, and I think that everybody involved would be better off doing it, when Congress gets to acting, usually nobody likes the result, and it would be better if it were done without Congressional action.

Mr. SMITH. Mr. Chairman, it is mine and Ambassador Brock's belief that the questions posed by the Houdaille case in the larger sense, the generic sense, must be addressed and addressed very quickly. Ambassador Brock has made it very clear to Minister Yamanaka that the dialog, or consultations on the entire question of industrial policies or industrial targeting must be begun immediately.

That is why he is meeting with the Minister in 2 days and that is why we have set up and established on really almost a crash basis this committee or working group at the subministerial level to examine fully all aspects of industrial policy as it pertains to international trade.

I would agree with Congressman Shulze, for example, that if one is not careful, this could become a political issue on which, perhaps, precipitous action could be taken without fully knowing all the ramifications of both the problem and, if necessary, the suggested remedies.

As I said in my prepared remarks, we are looking at this issue. I can think of nothing that I have spent more time on since I have come back from Geneva than this question. We are looking at this really sincerely and hard, and we would welcome the opportunity to cooperate with you, the Congressmen, and your staff as we get this examination going full speed.

Chairman GIBBONS. Well, I guess it gets right down to are we going to enforce the laws against the subsidy or are we not? Or are we just going to have to go out and invent some more laws? What is the policy of our Government? Is it to enforce the laws we like?

I will have to admit that enforcement seems to be better under the current administration of those laws, but where we have pretty much open and shut cases, are we going to every time say we have got to confer a little more about that?

I don't know anything about the merits of this case. I just got another letter from another person yesterday saying the Mexicans are subsidizing cement in this market.

I don't want to argue the merits of the case. As a matter of policy, I don't come down and meddle in your affairs about the merits of cases, but are we going to have—well, we can't do anything about the Mexicans because they are our friends.

They are on the border. Do we have to have another agreement with Mexico? If we do adopt this attitude toward the laws that are already on the books, nobody is going to have any respect for them and the whole process of running a government under law. We have done enough damage to it with the income tax laws.

People also have cynicism about them. Are we going to completely poison the well against the laws or are we going to start enforcing these laws?

Mr. SMITH. Mr. Chairman, I would agree with you that the vigor with which we are attacking subsidies has improved substantially. Over the course of the last several years, we have or have had at some time, up to 11 cases before the GATT or its committees.

Not all of these cases have yet been resolved or determinations made by panels. We are trying to address the subsidy question, not obviously just with Japan, but with the European Community as well.

We have had cases or we do have a case now, another aspect of GATT in the FIRA case with Canada, which was not subsidy, per se, but addresses another very difficult problem of performance requirements and perhaps domestic content.

I think that we are moving ahead with good speed. Clearly, there are other subsidy practices out there and I believe that we are trying to attack them.

With regard to Mexico, sir, as you know, we have been in various stages of consultations, or negotiations, to try to come to grips with them on their subsidy practices.

Secretaries Shultz, Regan, and Baldrige were in Mexico 1 month ago, and among the subjects discussed was subsidies. This is a particularly sticky one, but one which I think we must be sure that our obligations and our rights are full taken care of, particularly in view of the fact that Mexico is not a member of the GATT.

Chairman GIBBONS. And therefore, not entitled to get the benefits of the injury test.

Mr. SMITH. We are aware of that.

Chairman GIBBONS. All you have to prove under the law, per se, against Mexico is subsidy. Bingo, those duties ought to go right on. Now, what is the State Department going to say about that if that happens?

You know, here is where the cynicism begins to develop. The American businessman comes to me and says, "I can compete against anybody, I will compete against anybody, I don't want any protection, but I can't compete against a government subsidy."

Mr. **Lamb**. We certainly agree with that, Mr. Chairman. In fact, the subsidy problem with Mexico has diminished considerably with the devaluation of the peso from roughly 27 to a dollar to now 150. The Mexican Government has suspended its major subsidy program, and so we do not anticipate, as a matter of fact, as many cases of subsidy now as we have had in the past. It remains to be seen whether we can work out an arrangement with the Mexicans that would impose disciplines on them which would merit our coming to you with a proposal that, in fact, the injury test be extended to Mexico.

We will be discussing that.

Chairman **Gibbons**. Well, I am not going to be for extending the injury test to Mexico until they join the GATT and start complying with it. Don't come to me, telling me about Mexico ought to get the injury test and not join the GATT. They are either going to play the game the way the rest of the world plays it or else they are just going to have to sleep in their own bed.

I am sorry for interrupting you.

Mr. **Lamb**. Well, we would look in general, because of the currency relationships, for much reduced activity on the subsidy front with Mexico.

Mr. **Pease**. Would the chairman yield?

Chairman **Gibbons**. Sure.

Mr. **Pease**. I believe the chairman's question is what the State Department's attitude is going to be toward enforcement of the law when Mexico is caught subsidizing a product. It is not entitled to the injury test, and what you said is, with the devaluation of the peso, you anticipate fewer subsidies in the future.

I don't think that is responsive to the question and what we are after is what the administration is going to do when there is an open-faced violation of the law.

Mr. **Lamb**. Thank you, Mr. Pease. I would be happy to make my attitude or the attitude of the State Department clear. Basically, we take no role in the subsidy cases. They are determined by the Commerce Department.

Under the law, it would be inappropriate for us to intrude any other considerations other than those governed by the statute and we do not, as a matter of practice, attempt to do so.

Chairman **Gibbons**. That is good to hear.

Mr. Shulze

Mr. **Shulze**. Mr. Chairman, I have no questions at this time.

Chairman **Gibbons**. Mr. Frenzel.

Mr. **Frenzel**. Do I get a shot at both witnesses, Mr. Chairman?

Chairman **Gibbons**. Sure, or anybody at the table up there. I shot at everybody, so you are entitled to.

Mr. **Frenzel**. I would like to welcome Denis Lamb to our sanctum sanctorum here. He has extended courtesies to this committee and others in his previous incarnation and we are glad to have you back.

I have somebody here that I think is familiar with some of the Commerce aspects of the problem.

I think there is a constant feeling in Congress, Denis, that the trade interests are sold out for other broad geopolitical interests that may appear and that is not a specific complaint, but a general one.

I think we feel that perhaps most strongly in Japan where we feel that if Japanese offer us $1.25 more for base support that the United States caves on trade demands which are just as important, we feel, and are important in keeping our alliances strong and our economy strong.

So I think you need to be aware that that feeling exists whether it is justified or not, and it exists most strongly with respect to the United States-Japan relationship.

I think at least in the past, there has been some basis for that feeling. At least I feel it personally, but you are here today telling us that the State Department gives at least equal weight to the trade relationship?

Mr. LAMB. That is right, Mr. Frenzel. I think we in the State Department, as others in the executive branch, are conscious of the revolution the trade system has gone through in the last decade.

Our trade has increased tremendously and our dependence has increased tremendously. More firms, more individuals, more public officials and bureaucrats are dependent on successful management of the trading system.

It is no longer an objective that can be subordinated to a broader, vague political objective. In fact, it is a political objective on par with all of the others.

The speed with which we have entered this new era in which trade is much more important to our economy and much more important to that of our European allies and to Japan means that we are having trouble adjusting, getting our ways of thinking, our rules, our attitudes up to speed to deal with the greater dependency that we are subject to.

But we think within State that we understand the scope of the problem, and that it must be at the top of our list of priorities.

Mr. FRENZEL. I appreciate that, and if it is a reaffirmation of a policy, I hope you will tell your associates that we are pleased and if it is a change in policy, we are even more pleased.

We thank you for your testimony.

Mike, I think you have been in Geneva too long. Anybody that brings a 31-page piece of testimony to this committee is asking for trouble.

Mr. SMITH. Well, sometimes when you have heard some of these other delegations speak in Geneva, 31 pages is just their summary.

Mr. FRENZEL. In Washington, we only get ice water with our discussions.

Mike, as you know, this subcommittee, or members thereof representing the entire subcommittee, has just come back from Japan where it, I think, felt most frustrated in its discussions on the subject of industrial targeting, as the chairman indicated.

We believe that the Japanese that we talked to really didn't understand our complaint at all. With respect to NT&T, we came back frustrated and befuddled. We are obviously talking on two different data bases or communicating on the wrong frequencies with the Japanese.

We would agree with you, with the thrust of your testimony, that the current Government in Japan is far more sensitive to the problem and far more anxious to cooperate.

However, there is a long way from anxiety to implementing some real change and we hope that you will stay with that certification business, although Mr. Pease, I think, is probably better prepared to talk about that.

I think those standards changes were important, and I think that we may have disappointed the Japanese somewhat in our attitude, because I think we were not flattering enough in our description of the other things they have done, we have concentrated only on the Ottawa situation, which we thought was deficient.

But the chairman or president or whatever he is of NT&T will be in the United States in June. We expect to get together with him at that time, maybe with a supporting cast of thousands.

Will your Department work with our staff in trying to repair our information problem without revealing whatever proprietary information might be involved in your files?

We find that NT&T has quite a different story than the Americans who speak to us about their program and it is quite clear that the amount of dollars involved in NT&T purchases does not make the continuance of the agreement worthwhile.

Japanese are extraordinarily good sellers and extaordinarily bad buyers. It is amazing how the talent runs in only one direction.

You will probably be talking to these people on a more regular basis than we will, but I hope you will help prepare us and I hope you will help prepare them for what we hope will be an important meeting.

I wonder if you could tell us, what are you doing that we didn't do or that we couldn't do to convince the Japanese about our concern over industrial targeting? They look on it as you have described it, as an exercise in the sovereign power of their state, and we would grant that. We don't mind whatever they do in their own market.

We mind fiercely, however, when they plan an assault on our markets and then execute that assault in a very transparent and unfortunately effective manner.

Mr. SMITH. You asked what are we doing that you are not. I think what we are doing is just emphasizing the point more daily than perhaps you had the opportunity to do. I have met with the Japanese officials since I came home from Geneva, and said whether you like it or not, or whether we like it or not, or whether the Congress likes it or not, this issue is here and it must be looked at and determined if something is bad there, and if so, how do we fix it?

Ambassador Brock, Secretary Baldrige, and Secretary Shultz, have told them that this issue is important. There is at least, and I underscore, at least a perception, that the Japanese do forget and this issue has to be addressed, otherwise, as Congressman Shulze says, it will very quickly escalate into a major political issue.

I would also add that it is just not with Japan that we face potential problems. I believe we might have some problems on the other side of the world, with France in particular. The other point I have tried to make to the Japanese is that as a major economic superpower, which they are, this is an issue which threatens, if not taken care of, to undermine the body of agreements that we have built up with the Japanese or with the community, within the GATT over the past 35 years.

It has just got to be looked at. I think that message is coming through as typified by their willingness now, at a very high level, to begin the process of sitting down and looking at this issue in depth.

I think we are on to something, and we expect that the Japanese will fully cooperate.

Mr. **Frenzel.** Thank you.

One final question. We didn't concentrate as much on cigarettes as we might have, probably because Mr. Broyhill was expected to go with us and did not accompany us at the last minute, but are we making some progress there, or are we just playing the ongoing games that we have indulged in over the past 3 or 4 years?

Mr. **Smith.** Well, I have met recently with the representatives of the U.S. cigarette and tobacco industry. I thought we had been making good progress with the 30-yen reduction in the tariff that the Japanese had announced, and actually have put into place.

Unfortunately, the benefit of that tariff reduction has, perhaps, been reduced because Japan put a 20-yen surcharge on all cigarettes.

I would say that it is quite difficult for us to argue that they shouldn't have done it when the 20-yen surcharge was put on all cigarettes, regardless of whether they were foreign or Japanese.

But, nonetheless, in response to your question, I thought that we were making progress. The surcharge seems to take away some of that, so that the spread between the Japanese-manufactured cigarettes and the U.S.-manufactured cigarettes, is close to what it was 2 or 3 years ago.

Mr. **Frenzel.** Didn't that surcharge apply to Japanese cigarettes?

Mr. **Smith.** Yes; all cigarettes.

Mr. **Frenzel.** Well, obviously, it would be the same percentage.

Mr. **Smith.** Right. It is 20 yen flat for all cigarettes regardless of their prices.

Mr. **Frenzel.** Well, they did just what we did last year. They have the same kind of budget crisis as we do, but I guess I was thinking, I agree that there is a price problem and a problem of demand, of elasticity, and then a price differential problem, but the distribution problem is perhaps worse.

Do we have an agreement to get into a reasonable number of stores?

Mr. **Smith.** If I could ask Mr. Murphy for the latest on that.

Mr. **Murphy.** They have been consistently accelerating the pace that they are giving us access to the retail outlets. We have continually asked them why there has to be this slow implementation. They have never satisfactorily answered the question why we were not given immediate access, but they have at least been giving us continued access to those outlets and I think by March 1985, they will give us access to all retail outlets, a total of 250,000.

Prior to that time, we will have access to the higher volume retail outlets in the major cities, and I think they plan to give us complete access to the Tokyo and Osaka outlets in major population areas by later this year.

Mr. **Frenzel**. How about restrictions on advertising and shelf space, et cetera?

Mr. **Murphy**. The restrictions on advertising relate to the dollar amount of expenditure that you can make and those are still quite severe.

Our companies find that the amount they can spend is such that it essentially denies them very great access to the most popular media, particularly television, which is extremely expensive. This is a point which we have been pursuing with the Japanese.

It has been secondary in the minds of our companies to the tariff question, but having made some progress on that, I think our focus is now going to turn more to the distribution and advertising issues.

Chairman **Gibbons**. Will the gentleman yield?

Mr. **Frenzel**. Thank you. I yield to the chairman.

Chairman **Gibbons**. We don't make them sell our cars through a U.S. monopoly. Why should they make us sell our cigarettes through a Japanese monopoly?

Mr. **Murphy**. The question of a continued existence of monopoly, as the chairman is probably aware, has been the subject of a study by the OTO Commission, which was completed last summer. The results of the Commission study have been under review by the Japanese Government with regard to whether the monopoly should continue as a public monopoly or whether various options such as a privatization or breakup of its various functions should be considered.

For example, it may continue to have a monopoly on the production of domestic cigarettes, but the distribution of foreign cigarettes might be turned loose. These options have been under consideration by the Japanese Government, but to this point, they have not made any determination as to which way they are going to go on the Commission recommendation.

But your point is one that we have made to them numerous times, and obviously, they would sell fewer Toyotas in this country if they had to sell them through a monopoly of U.S. automobile manufacturers.

I would sensitize them to that, but it is a major political problem on their side.

Chairman **Gibbons**. Everything is a major political problem on their side. Baseball bats, oranges, baseball gloves, cigarettes, rice. Everybody has political problems, but it is always a one-way political problem, it seems to me.

They don't realize, I think, that we have political problems. I am expressing one right now. They make cigars in my area, and what they do to the cigar industry over there is atrocious. I think my people are being very nice to have raised as little hell about it as they do, but they mark those pitiful little cigars up about 10 times over there and say, "People don't like the cigars in Japan. Nobody but the Emperor could afford them."

Mr. **Frenzel**. Mr. Chairman, I yield to the gentleman from Pennsylvania.

Mr. **Shulze**. Wasn't there also a problem with point of purchase advertising and has that been resolved?

Mr. **Murphy**. Yes, there were problems. There were allegations made both by the companies and by USTR to the Office of Trade last year, with regard to the disappearance from point of sale of various advertising materials, both the illuminated light boxes and cardboard posters.

These complaints were investigated and the responses were something less than satisfying, quite frankly. We were given an accounting for each light box that they were knocked over by a child playing or a typhoon wind knocked it off and destroyed it.

But separate complaints were made to both the VTS and the OTO on this point. Since then, there seem to have been a dropping off of that kind of complaint. We weren't satisfied with the responses we got, but the act of complaining seems to have, at least for the moment, stopped the disappearance of point of sale advertising.

Mr. **Shulze**. Have those that disappeared been replaced?

Mr. **Murphy**. The ones that were broken have not reappeared. I think the companies were skeptical, but the light boxes were not given back.

Mr. **Shulze**. It is the usual response, give an answer, be nice and smile, but really do nothing.

Mr. **Murphy**. Yes.

Mr. **Frenzel**. Mr. Chairman, I have overused my time.

Chairman **Gibbons**. Yes, we have.

Mr. Pease.

Mr. **Pease**. Thank you very much, Mr. Chairman.

I would like to welcome both of our witnesses, too. It is good to see them in an overseas connection, and it is good to see them back here in the United States. I would like to ask the question, in the testimony that was given today, everybody seems in agreement that the goal ought to be to make the Japanese market accessible to U.S. firms on a no less equal basis than the American market is open to Japanese firms.

Have we agreed that is the goal?

Mr. **Lamb**. Yes.

Mr. **Pease**. I would like to get some feeling for where we stand in our progress toward that goal. On a scale of 1 to 10, how far along the scale are we if 10 is comparable access?

Mr. **Lamb**. Mike Smith may not remember this, but Ambassador Brock was asked a similar question. He does remember it. A few months ago, he was asked and he said 2. We are at maybe 2 point something in my view, Mr. Pease.

Mr. **Pease**. Where would you say we would have been a year ago, before these recent changes that you just outlined were initiated?

Mr. **Smith**. Less than 2.

Mr. **Pease**. I think that seems logical enough. I want to compare this with defense spending. I am not an advocate of forcing the Japanese to spend more money for defense on the theory that they will be less able to spend the money on targeting U.S. industries.

I think your argument remains that we spend 6 percent of our GNP on defense and the Japanese spend about 1 percent, and we hear stories that they are going to try to increase their defense spending. I understand their increase is up to about 8 percent a year now. If they are at 1 percent now and increase at 8 percent a year for the next 10 years, they will be up to 2 percent.

Now, is the same thing going to be true with opening up their markets? If they are at 2 now and they proceed at the pace they are going, where will they be 5 years from now?

Mr. SMITH. Well, not being a defense expert, I will just answer the trade side.

Mr. PEASE. That is fine.

Mr. SMITH. Certainly using the rule of 72, they are only incrementally increasing their access, and we would not have problems in 5 years but in probably 50 years. That is not our objective. Our objective obviously is to get them to open their market as fast as humanly possible. Ambassador Brock said that on your scale of 10 that it was roughly 2, and that we had made more progress in the past 2 years than we had in the previous decade.

The problem is symbolized on the agricultural side where, as you know, the Japanese do maintain quotas which we believe are GATT illegal. It is nice to win the argument in the GATT, but the real proof of the pudding is getting the access into the market. We want the Japanese to eliminate those quotas so that we can sell there unfettered by government restraints.

Whether or not we increase sales thereafter is our problem and not theirs, and we hope, beginning with our conversations this afternoon, that we will see real progress from the Japanese, meaningful progress on, for example, agriculture so that we don't go from a scale of 2 to 3, but you go from a scale of 2 to 6 and 10 within a set period of time.

We are aware of this alleged political problem in certain agricultural products. Everybody has political problems in agricultural products. They are not alone, because we have a few. But they simply must help by opening up their borders in, for example, these agricultural products, and we intend to do everything that we possibly can to push this home. I have some reason to believe we may have some success.

Mr. PEASE. Following agriculture for 1 minute, 5 years from now, what is your estimate of where we will be on our scale of 1 to 10?

Mr. SMITH. I would assume that we will be at 10.

Mr. PEASE. Within 5 years?

Mr. SMITH. Yes, sir.

Mr. PEASE. How about our manufactured goods?

Mr. SMITH. That is crystal ball gazing. We don't know what the effect will be of the 17 changes in the laws. As to how much impact that will have immediately, we are more than reasonably confident that this will have a very positive impact if American manufacturers choose to exercise that.

Equally, however, the Japanese have a responsibility not to come up with other little devices in the interim to frustrate those steps that they have undertaken on March 26. We will be watching this very, very closely because we have spent a great deal of time on their standards and certifications.

I, for one, have always found it mindboggling, their standard on baseball bats. I just couldn't believe that it was necessary for two major economic superpowers to have to spend many months to resolve an issue on baseball bats, particularly since we invented the game.

But that is behind us, and hopefully we will start selling baseball bats, gloves, tennis balls, and things like that. In direct response to your question, I can't tell you whether we will be at 10 in 5 years. I am not quite sure whether we are in the manufacturing side right now.

When Ambassador Brock talked about access on the 0-to-10 scale, you have to include agriculture so perhaps we are at 3 or 4 in the manufacturing side. I simply don't know how to answer that, sir.

Mr. PEASE. When we are talking about free trade, we hear a lot said about the theory of comparative advantage. It seems to me that the Japanese have worked comparative advantage in another sense. If we are operating terms of access to our market at the 10 level and they are operating at the 2 or 3 level, that is a great comparative advantage for them, which was never envisioned by Adam Smith.

If I were the Japanese Government and thought that I could stretch out the process so that 10 years from now, I had gone from two to five and the Americans were congratulating themselves for having made such great progress, I would be very, very happy. They have still got the comparative advantage.

It is a little smaller, but still they are 10 years out from that, and I wonder on the basis of that whether we wouldn't be justified in adopting maybe one of two approaches. One would be for us to go down to 2 in terms of our allowing Japanese access to our markets and then go up together to 10, lock step, 3, 4, 5, marching arm in arm all the way.

Or whether we wouldn't be justified, conversely, in pursuing a result based policy where we say, what we are going to judge you by is not whether you open your markets but whether there is any actual change in U.S. imports to Japan of beef or citrus or electronics or cars, or whatever.

Would you endorse either one of those policies?

Mr. SMITH. Well, I don't think I would endorse your first option, sir. The second, is results based policy, and is similar to what we are doing, for example, in the NTT agreement. I would agree with Congressman Frenzel that based on what we have now seen in the results of the NTT, they have not produced the results and, therefore, if one had to make a decision today on April 26, I think it is safe to say that this administration would not come to the Congress recommending renewal of that agreement because the results have not been what we had anticipated.

I think the same would go on our agreement with the Japanese in certain agricultural products. That too is a result based agreement. The problem on the agriculture side is that I would much prefer to see us get the access rather than just saying, well, we won't have an agreement so we will take you to the GATT or maybe we could take them to the GATT at the same time as we asked for the results.

I want to get back to the possibility that foreign policy considerations enter into the decisions by the Government regarding remedies for complaints brought by U.S. firms of unfair trade practices. I think you know there is a very clear perception among a lot of

American businessmen that the U.S. Government is not only not favorable toward them in their dealings with foreign competitors, that they are not only not playing on a level field, but that they have an adversary in the U.S. Government in their efforts to compete with U.S. firms.

Are you aware of that perception?

Mr. **Lamb**. It arises from time to time. In fact, the whole evolution of our arrangements for managing trade policy I think reflect that and respond to it. As our involvement in the world economy has grown, the influence has shifted clearly away from the Department of State to the USTR. And that I regard as a natural and appropriate shift.

Mr. **Pease**. Secretary Lamb, you said that the State Department does not seek to influence decisions on trade remedies because of foreign policy considerations. Is that true?

Mr. **Lamb**. Well, I answered a narrower question that had to do with subsidy petitions brought to the Department of Commerce and we certainly stay away from those.

We are heavily involved and interested in a whole range of other trade complaints where both domestic and public trade policies should be raised and factored into a final decision on the part of the Executive. Yes, we are interested.

We bring a particular expertise to these discussions having to do with the nature of foreign economies and societies, what can be accomplished in the way of obtaining a remedy other than imposing a sanction, and we try to be helpful in that way.

Mr. **Pease**. What about the Houdaille case? Did you get involved in that?

Mr. **Lamb**. We were intensely involved in the Houdaille case, and have taken part in deliberations over it and discussion of that petition. The enormous supporting material that was assembled by Houdaille was looked at in extremely fine detail on an interagency basis. We did participate, as I say, quite fully in that, and we have learned a lot from it, I might say.

One of the things, which in a way is startling but perhaps on reflection ought not to appear so, is that we don't know enough about the complex of practices—some of them related to trade, some of them not—that other countries, in particular the Japanese, use to influence the direction of their domestic economies.

We did learn a lot in looking at Houdaille that will be extremely helpful in the consultations that Ambassador Brock is initiating, but we did find out we need to know more.

Mr. **Pease**. Mr. Secretary, could you outline just briefly the types of situations where the State Department does get involved and the types where the Department does not get involved?

Mr. **Lamb**. We try to get involved in as much as the USTR will let us get involved in. All of these issues and the way they are handled do have implications for broader foreign policy objectives, and we try to stay current and to inject what we can in the way of diplomatic intelligence into the interagency deliberations on trade issues.

Mr. **Pease**. What about subsidies then? If there is a complaint by an American firm that the Mexicans are subsidizing cement, do you get involved in that?

Mr. **Lamb**. Not necessarily on that. We would be aware of that. I doubt that we would have anything particular to say about it.

Let me offer you another example: The agreement between the United States and the European Community that ended our carbon steel problem. That was basically an operation by the Secretary of Commerce, and we retained an interest in it, not in terms of interfering in any way with the conduct of the investigation and the petitions, but we were supportive of the general notion that a negotiated solution, which would have the effect of eliminating the practice to which we objected and to which our industry objected, was on balance better for the conduct of our overall trade relationship with the Community than would another solution. We made that general point of view known.

Mr. **Pease**. So, American industry might reasonably state, based on what you have said, that if the industry feels it would be better to have sanctions imposed because of subsidies or dumping and the State Department does not and the State Department prevailed that the Government interfered to thwart the law?

Mr. **Lamb**. I must say, Mr. Pease, my basic perception from where I sit in the State Department is that the business community comes to us to seek redress usually at the early stage of a trade problem that they face. They want the matter raised bilaterally. They want the United States to exercise its political powers of persuasion to eliminate the practice that concerns them, and we are quite sympathetic in most cases to that and we try to do that.

The businessmen that visit me don't take me on as an adversary, I must say.

Mr. **Pease**. I infer what you are saying is the businessmen are willing to come under certain circumstances and seek your help. There are other times when they would just as soon not have you involved. They want to have their cake and eat it too?

Mr. **Lamb**. I think they look at their options, yes, sir.

Chairman **Gibbons**. Would the gentleman yield right there because I asked you the question a little earlier, does the State Department get involved in unfair trade practices cases, and as I recall your answer, it was no.

Now you have just recited two unfair trade practices matters in which you said you did get involved. One was the Houdaille case. Now admittedly Houdaille is a little different because it wasn't being decided by Commerce, and that is what you limited your answer to.

But now the steel case was being decided as a countervailing duty case under law, and you just said that you did get involved in that. Now, do you want to go back and elaborate a little more? I am really perplexed.

Mr. **Lamb**. Yes, Mr. Chairman. The resolution of the steel case was under the direction and leadership of the Secretary of Commerce who also was responsible for supervising the conduct of petitions. It was resolved with the full agreement of the industries concerned who decided. That was their sovereign right in this case to withdraw the petitions. The State Department's role was limited to generally supporting the objective of a negotiated solution provided that our industry could be satisfied, as in fact they were.

Chairman GIBBONS. You satisfied a part of industry, the integrated steel producers, but did you satisfy all of the little minimills that produce 25 percent of our steel, or did you just even forget they existed?

Mr. LAMB. No, sir. We have some ongoing cases; specialty steel.

Chairman GIBBONS. I am not talking about specialty steel. I am talking about carbon steel rod and people like that. You just kind of overlooked 25 percent of the American steel production in settling those cases.

Mr. LAMB. Well, those were settled on the basis of particular petitions brought to the Secretary of Commerce and, yes, we did only address the content of those petitions.

Mr. PEASE. Mr. Chairman, I would like to ask Ambassador Smith about the USTR and its relations with the Commerce Department on unfair trade practices cases? Could you get involved in consulting, or urging solutions upon the Commerce Department?

Mr. SMITH. I will ask Mrs. Archibald to answer that, if I can, since she is involved in it from day to day.

Ms. ARCHIBALD. Mr. Pease, it probably would be helpful in this discussion if we differentiate between different types of unfair trade practices and the different laws that are on the books to deal with them. The Commerce Department, as I am sure you know, deals with countervailing duty and antidumping petitions, and the differentiation of roles between USTR and Commerce on cases of that type was very clearly laid out in the reorganization plan back in 1980.

The Commerce Department does, indeed, make the decisions on whether or not there is a subsidy, whether or not there is a less than fair value sale and, if so, what the amount is. Now there can be in some cases, general policy issues that arise in countervailing duty cases, for example, in which we may have an interest. In fact, that overlap or that coordination of complementary jurisdictions that we have or interest that we have in these matters is becoming clearer.

We have a statute which we administer, section 301, which is a more general unfair trade practice statute and we can, and do, in fact take up subsidy issues in that context, but not in the same context in which the countervailing duty case is sought.

The objective in the two statutes is different. The countervailing duty statute which you are looking at is possible imposition of a duty on a specific product in an effort to neutralize the effect of a particular subsidy practice.

In the 301 case, if we get a subsidy issue, our approach is to take it to the international forum which deals with subsidies, either the GATT or the subsidies code, and to attempt to get a ruling on the propriety of the practice, itself, which would have a broader impact than just on the particular product involved.

In the 301 case we certainly do obtain, well, we follow a full interagency process that would include not only the Commerce Department but the State Department, Agriculture, Labor, whoever has an interest in trade policy, and that is also a standard procedure laid out in previous statutes. USTR chairs that interagency process, so they do play a role and really on this heavily, not only for policy guidance but for their expertise as to how they have dealt with specific issues as they have arisen in countervailing duty cases.

As I started to say earlier, we have begun to notice in some of the 301 cases that we are getting that there appears to be a certain overlap. People are coming to us sometimes when they could otherwise go to CVD.

So far, that appears to be appropriate, but in dealing with those types of cases, we want to insure that the policy we follow complements the policies as they have been developed by Commerce, and we look forward in the future to a very close working relationship on policy issues but not, and I want to emphasize this, we do not influence their decisions on specific rulings in countervailing duty and dumping cases.

Mr. **Pease**. I will be happy to yield to the chairman.

Chairman **Gibbons**. You raised a very important point and one of the things that I will admit I have been thinking about in trying to figure out what we can do about unfair countervailing subsidy and dumping practices, leaving out section 301 because I realize that is another ball game.

I frankly want a set of laws in countervailing and dumping cases, laws that people can understand what the outcome is going to be when they begin action in them, and that is why I have been so interested in what the State Department's role is and what your role is in this whole matter.

One of the solutions that I have been thinking about is to further insulate the countervailing duty cases and the dumping cases from the political process; that is difficult in our Government. As I say, I, as an individual Congressman, don't get involved in dumping cases or countervailing duty cases. I think we ought to follow the law there.

I realize section 301 has other connotations to it, and I realize the escape clause has other connotations to it but I frankly would like to further isolate the dumping and the countervailing duty/subsidy cases from the political process.

I have even thought about taking the whole thing and putting it over in the International Trade Commission and giving further insulation to that. I have thought about maybe in this reorganization plan that is coming up that we could do it through that, maybe somewhere within the administration.

I thought about giving the courts and the executive branch and the judicial branch greater supervision over political interference in the whole area of dumping and countervailing duty cases because I think there has been too much political tradeoff in these matters and cynicism has developed over the whole system of law.

Those are the ideas I have, and I think your responses to Mr. Pease's questions are very important.

Mr. **Pease**. Mr. Chairman, I think I have also taken more than my alloted share of time.

Chairman **Gibbons**. Mr. Hance.

Mr. **Hance**. No questions.

Chairman **Gibbons**. Mr. Jones.

Mr. **Jones**. Thank you, Mr. Chairman.

You mention in your testimony, Ambassador Smith, about the capital investment flowing to the two countries, that it is about even now but not very much in either direction. Could you tell me if there has been any particular difference in 1982 versus 1977 in terms of Japanese capital investment in the United States?

Mr. SMITH. Mr. Congressman, I don't know the answer to that question specifically. I can find out and provide it for the record.

Mr. JONES. I wish you would.

[The information follows:]

In 1977, Japanese direct investment capital flows to the U.S. were $587 million; in 1982 they were $1,897 million.

Mr. JONES. You also mentioned in your testimony that the beef and citrus agreement will run out in the spring of 1984. If a new agreement is not reached, are we prepared to go to GATT on these two issues?

Mr. SMITH. Yes, sir.

Mr. JONES. I want to ask a little bit about the trade liberalizations announced a few weeks ago, and I might point out that I don't know whether you say it in your testimony or not, but I certainly get the feeling that the Nakasone Government is making the first genuine attempt to have two-way trade between our countries. I don't know what kind of political problems he is going to suffer in Japan for that and whether he will survive it and whether it will be appreciated in this country, but I, for one, appreciate what the Government is doing.

I guess my question is, Are you seeing any real followthrough? For example, in automobiles, could you tell us what the domestic U.S. manufacturer of automobiles says about the certification process that was announced? I talked to some of the manufacturers after this announcement, and they were going to look at it, but really hadn't decided whether it was going to help them or not.

Have we had any more direction or comment from the U.S. industry?

Mr. SMITH. I touched upon that briefly, sir, in my summary remarks. Maybe Mr. Murphy could give his reaction.

Mr. MURPHY. I think at this point, Mr. Jones, as you know, the changes have not been put in place yet, and so our companies have not yet had the experience of living under the new regime. Further, beyond that, we have not yet seen the precise language so we don't know what changes will be made in those statutes.

And, of course, as Ambassador Smith said earlier, the absence of the self-certification element clearly was a disappointment.

Mr. JONES. They have self-certification for their cars coming here, and they have not proposed that for U.S. cars going to Japan.

Mr. MURPHY. That is correct.

Mr. JONES. What other major differences, what other advantage do they have in the exporting of their cars to the United States over U.S. manufacturing exporting an American-made car to Japan based on their proposed new rules?

Mr. MURPHY. I would say the biggest major advantage they have is simply in the volume of sales they have which allows them to run production lines exclusively for this market and thereby avoid a lot of the tailoring to the market that our companies must do by running with smaller numbers.

Mr. **Jones**. But that is a management decision and not a Government decision necessarily, is it?

Mr. **Murphy**. It is a function of economics to a large extent with the small volume of cars, only some 4,000 U.S. cars total were shipped to Japan last year, it is not economically feasible to run a production line for that market.

That means you are taking cars off your regular production line and tailoring them to that market.

Mr. **Jones**. I understand the process and reason, but that is more a function that our manufacturers have made a management decision to do it that way, that they have not really gone after that market. My point is, assuming they decided to go after that market in larger volumes, what disadvantages would they have by a Government decision that the Japanese exporter would not have other than the self-certification?

Mr. **Murphy**. I don't think we can precisely answer that until we have seen the language changes in their statute and know exactly what changes will be made. At this point we simply don't know.

Mr. **Jones**. And when is that expected?

Mr. **Murphy**. The documents, as I understand it, are being finalized by the Japanese Cabinet to be submitted to their Diet we think this week or next week and presumably will be made available to us at that time.

Mr. **Jones**. Let me ask you about the GM/Toyota arrangement in California. The FTC is looking into that. Have you made a comment on the antitrust actions of that?

Mr. **Murphy**. No, sir, I don't believe we have commented on that.

Mr. **Smith**. Mr. Jones, I was told by my staff that there is one advantage that the Japanese do have, and that is that Japanese law permits exclusive distributorships. Our law, of course, does not.

Mr. **Jones**. Have you taken this up with the Japanese?

Mr. **Murphy**. Yes, sir. We have, as well as all of the others that we have pursued with them for the last several years.

Mr. **Jones**. What is their response on this?

Mr. **Murphy**. I don't frankly recall, exactly. I am sorry. We can supply that for the record.

[The information follows:]

In our discussions with Japanese Government officials, we have raised the issue of impediments to retail distribution in Japan of U.S. automobiles. Specifically, the discussions have been on the very close relationship between Japanese auto manufacturers and their dealers, including in many instances equity participation by the manufacturers, which has established a business environment in which a Japanese dealer will represent only a single domestic manufacturer's product. This practice has effectively limited the marketing options for U.S. producers who have had to recruit and maintain a dealer network in Japan from scratch. This is in sharp contrast to the experience of Japanese manufacturers in the U.S. market where many were able to negotiate retail distribution arrangements with established U.S. dealers who also handled domestic products.

The Japanese Government responded that this past business practice results from tradition and is not imposed upon the dealer by the manufacturer through exclusive franchising contracts or compelled by Japanese law. They also pointed out that in the distribution of foreign autos in Japan, many Japanese dealers handle the products of more than one foreign manufacturer.

Mr. **Jones**. I think Mr. Frenzel touched on the NTT, so I won't go into further detail there, except to say that that is a great disappointment for me too. When Mr. Frenzel and I and Mr. Gibbons did a previous report, that was clearly an area that had a large volume of business. We were competitive and to have $30 million out of $3 billion, or so, purchases going to U.S. companies is inadequate.

I gather that you have a real bureaucracy problem there. Dr. Shinto seems to be willing, but nobody else is, and he doesn't seem to run the show there. I suppose, going back to what Mr. Pease said, it is results that count, and that is one as far as I am concerned where results are going to be the determining factor.

My final question deals with the yen versus dollar relationship. There is a general feeling that somehow it is being manipulated and that, if the government so desires, a more proper relationship could be engineered. But there is a big disagreement as to whether or not that can be done.

Would you comment on the yen versus dollar relationship and what the government of Japan can or should do about it?

Mr. Smith. Sir, I am not an authority on monetary exchange. I would say, from a personal point of view, nothing could be more beneficial than if somehow magically the yen appreciated a little in value and the dollar depreciated a little in value.

I have, in anticipation of this hearing this morning, asked several of my friends in CEA and Treasury their view on whether there was manipulation of the yen/dollar rate, and I am assured by them that there is not. And not being an expert on this subject or following it every day, I will, of course, accept their statements which they say they have made exhaustive studies on this.

Mr. Jones. Thank you, Mr. Chairman.

Chairman Gibbons. Thank you, Mr. Jones.

Let me say on NTT, when Dr. Shinto is in this country I have already extended the invitation to him to come sit down with me and with members of the United States that want to do business in Japan, and we are going to have a closed door, off-the-record discussion because never in my 63 years have I ever been told that black was white and white was black like I have been in the NTT, U.S. manufacturers discussions.

So I want to invite the American manufacturers and all members of this subcommittee that want to sit down in my office. We are going to find out where the facts lie as best we can in that face-to-face square off on it because there is no sense renewing that agreement unless we understand where we are going on it. We haven't gone anyplace in 3 years.

Mr. Smith. Mr. Chairman, if I may say, as I said earlier, I agree with a lot of those sentiments. Out of fairness, I think even our American businessmen who have been in contact with NTT have expressed some satisfaction, at least administratively the way NTT has taken an effort to translate documents into Japanese so that the specifications could be acted upon in the Japanese language.

Chairman Gibbons. This is not just a one-sided problem. I understand that. I can imagine what would happen if we insisted that our purchasers in this country handle their bidding in Japanese. We would have a revolution among our other domestic suppliers here, and I realize that the Japanese have gone that far, but either we are damn lousy suppliers or there is some trouble over there. I want to find out what it is.

Have you all ever sat down face-to-face and brought the American business community in with Dr. Shinto to get to the bottom of this thing?

Mr. **Jones**. Let him bring his bureaucrats in.

Chairman **Gibbons**. We have had his bureaucrats too, and they tell the same story that he is saying. I don't know where the truth lies in this argument. But have you all ever done that, just had a face off with each other? I realize we are getting over into Mr. Murphy's area of negotiating, but they are telling completely opposite stories from when you see them one at a time.

Mr. **Smith**. I am aware of the contradictions in what they say and what we say. Obviously, I believe that what we say is more reflective of the actual situation. Ambassador Brock has sat down face to face with Dr. Shinto. I believe that our American businessmen have also met with Dr. Shinto.

I can't say, having not been in Tokyo at that time, whether American businessmen and Ambassador Brock and Dr. Shinto sat down.

I believe they did not.

Chairman **Gibbons**. We are excluding them from a large share of U.S. market if this thing is not agreed to, and I don't want to exclude them from their proper share of this market, but what the U.S. manufacturers tell me and what Dr. Shinto tells me are as far apart as the North and South Pole.

Mr. **Smith**. I understand that. Our figures, as we have said in our testimony, show that NTT purchased goods from U.S. companies valued at $34.4 million out of a total procurement of about $3 billion.

Mr. **Frenzel**. That is in 1982?

Mr. **Smith**. Yes, sir.

Mr. **Frenzel**. We probably should have stuck with the brooms and mops.

Mr. **Smith**. I was wondering when that would come up.

Chairman **Gibbons**. Well, I want to thank you gentlemen for coming to help us this morning. You have been helpful.

Mr. **Smith**. Thank you, Mr. Chairman.

Mr. **Lamb**. Thank you, Mr. Chairman.

Chairman **Gibbons**. Next the General Accounting Office, Mr. Mel F. Berngartt.

Sir, would you identify yourself for the record and tell us what you have got on your mind here this morning.

STATEMENT OF MEL F. BERNGARTT, DEPUTY ASSOCIATE DIRECTOR, INTERNATIONAL DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY PEGGY McGREGOR AND KATHERINE VUICICH

Mr. **Berngartt**. I am Mel F. Berngartt, Deputy Associate Director with the International Division of the General Accounting Office, and I am accompanied by two of my colleages who were the principal participants in the work and in the drafting of the reports that we are testifying on today.

On my left is Peggy McGregor and on my right is Katherine Vuicich.

Last Thursday we submitted our full statement and we have a brief summary statement.

Chairman GIBBONS. I have been carrying that around all weekend trying to get to read it but the flight back and forth to Florida is so rough I couldn't read anything on it so I settled down to a more pleasurable activity on the plane.

Could you tell me what is in that report?

Mr. BERNGARTT. Sure. We have a brief statement here.

We are testifying on our reports, "Industrial Policy: Japan's Flexible Approach", and "Industrial Policy: Case Studies in the Japanese Experience".

Our work focused on exploring the contribution of macroeconomic policy to industrial growth, determining those policies which support growing industries and determining those which assist declining industries.

We examined Japan's past and present experiences with industrial policy, and we reviewed the goals and tools of Japan's industrial policy to assess how and why they have changed over the postwar period.

In addition, we discussed how macroeconomic monetary and fiscal policies have contributed to achieving the goals of industrial policy.

From World War II through the early 1970's the widely accepted consensus in Japan strongly supported government efforts to reconstruct the Japanese economy by rebuilding the nation's basic industries and by working to catch up with the technology of the United States and Western Europe.

This was accomplished by using tools such as:

First, strict foreign exchange controls;

Second, commercial policies which gave incentives to exports and restricted imports and;

Third, controls over foreign investment and the acquisition of technology.

Monetary and fiscal policies reinforced the effectiveness of these tools in a number of ways, primarily by:

First, keeping interest rates low, thereby both lowering the cost of investment and generating demand for loanable funds that exceeded supply;

Second, placing strict controls over domestic capital market, which effectively prevented these markets from becoming a major source of free market capital;

Third, administering a tax system which favored savings and investment; and

Fourth, channeling government-controlled resources into productive investment.

In the early postwar years, policy goals were primarily oriented toward rebuilding specific basic industries and an industrial infrastructure.

By the midsixties, Japan had largely achieved its postwar development goals and began placing growing emphasis on technology and social development issues.

Following the economic turbulence of the midseventies, Japan has focused on adjusting to stable growth, supporting resource conservation and environmental improvements, while continuing to support the development of new technology.

With these changes in the goals of industrial policy, tools to implement these goals also changed. Such changes are attributed to numerous factors, including:

First, the financial success of Japanese firms which left them less dependent on bank debt financing;

Second, the relaxation of domestic regulation of financial markets, which opened new avenues of financing to firms, for example, stock and bond markets;

Third, international pressure and obligations of Japan, such as those under the International Monetary Fund and the General Agreement of Tariffs and Trade;

Fourth, increasing budget deficits, which placed constraints on the government's ability to finance industrial developments; and

Fifth, a rising class of structurally depressed industries.

Government influence over key industrial sectors began to weaken as a result of these factors.

The emphasis of industrial policy for growing sectors today is on developing and diffusing technologies throughout the economy. Industries such as computers, robotics, and aircraft which contribute to goals of higher value added production, greater productivity, and resource conservation benefit from government support. The support includes such things as financial assistance for joint government industry research and development, and tax incentives and special leasing programs for technology diffusion. These mechanisms, for the most part, work through incentive rather than control.

Rising labor costs, sluggish world demand, lower priced products from Southeast Asia and Korea, increased raw materials costs, and foreign market import restrictions have all contributed to severe economic disruptions for some Japanese industries. In a slow growth period, adjustment is increasingly difficult.

The government has attempted to assist declining industries adjust to new circumstances by addressing short-term price and production imbalances and designing programs to ease long-term structural problems. This includes providing incentives to scrap excess production capacity and encouraging movement into other more competitive industrial segments.

The government also assists workers in these industries through a number of unemployment and reemployment programs. In addition, large multiproduct firms play a significant role in the adjustment process.

In conclusion, a key element of Japanese industrial policy has been the flexibility of the government and its programs in responding to the pressures and constraints of the domestic and international economies. However, the government's ability to direct the course and speed of industrial growth in light of an increasing number of conflicting priorities and legislative and structural changes in industrial policy tools is unclear.

Mr. Chairman, that concludes my statement and I and my colleagues would be happy to answer your questions.

[The prepared statement and attachment follow:]

STATEMENT OF ALLAN I. MENDELOWITZ, ASSOCIATE DIRECTOR, INTERNATIONAL DIVISION, GENERAL ACCOUNTING OFFICE

Mr. Chairman and members of the Subcommittee: We are pleased to be with you today to discuss our reports, "Industrial Policy: Japan's Flexible Approach" (GAO/ID-82-32) and "Industrial Policy: Case Studies in the Japanese Experience" (GAO/ID-83-11). Our work focused on (1) exploring the contribution of macroeconomic policy to industrial growth, (2) determining those policies which support growing industries and (3) determining those which assist declining industries.

We examined Japan's past and present experiences with industrial policy. We reviewed the changing goals and tools of Japan's industrial policy to assess how and why they have changed over the postwar period. In addition, we discussed how macroeconomic monetary and fiscal policies have contributed to achieving the goals of industrial policy.

In Japan, macro- and microeconomic policies have worked together to achieve governmental goals. Microeconomic industrial policies helped to achieve broad economy-wide goals through their impacts on individual industries and sectors, monetary and fiscal policies reinforced the effectiveness of industrial policy tools by creating conditions that favored investment and growth.

INDUSTRIAL POLICY AFTER WORLD WAR II

The widely accepted consensus in Japan from World War II through the early 1970's strongly supported government efforts to reconstruct the Japanese economy by rebuilding the nation's basic industries and by working to catch up with the technology of the United States and Western Europe.

Japan, in the early postwar period, marshalled a large array of industrial policy tools which enabled the government to strongly influence the rate and direction of economic growth.

These tools included: Strict foreign exchange controls; commercial policies which gave incentives to exports and restricted imports; and controls over foreign investment and the acquisition of technology.

For example, foreign exchange controls were used to direct resources to targeted industries and to limit foreign competition in the domestic market. The Foreign Exchange and Foreign Trade Control Law operated through a system consisting of a foreign exchange budget and import controls. The foreign exchange budget set the amount of foreign currency available for the year and allocated it among sectors of the economy. This enabled the government to effectively allocate foreign exchange and, thereby, to direct raw material imports and the acquisition of foreign technology to targeted sectors; for example, steel and chemicals. During this period, the government protected domestic industry by carefully restricting competition from imports and foreign industry through the use of import controls and controls over foreign investment in Japan.

Monetary and fiscal policies reinforced the effectiveness of these tools in a number of ways, primarily by: Keeping interest rates low, thereby both lowering the cost of investment and generating demand for loanable funds that exceeded supply; Placing strict controls over domestic capital markets, which effectively prevented these markets from becoming a major source of free market capital; administering a tax system which favored savings and investment; and channeling government-controlled resources into productive investment.

By restricting capital markets and keeping interest rates artificially low, the government was able to effectively control which industries had access to Japan's limited capital. Firms were largely dependent upon Japan's 13 major city banks for financing industrial development. The city banks, in turn, were dependent upon the Bank of Japan in order to expand their loanable funds. This interrelationship enabled monetary authorities to effectively ration credit through the city banks to targeted growth sectors. Non-targeted sectors were denied access to this cheap capital.

Fiscal authorities allocated budgetary funds to targeted industries as well. Household savings were primarily deposited in the savings system operated through the nation's post offices. These savings were channeled by the Ministry of Finance to the Fiscal Investment and Loan Program (FILP). The funds were in turn allocated to government financial institutions, such as the Japan Development Bank and Japan's Export-Import Bank, to implement government economic policy goals. Signficant funds from the FILP were thus allocated to targeted industrial sectors to stimulate industrial development. The FILP account has been as large as 50 percent of Japan's general account budget and thus has accounted for significant assistance to Japanese industry.

CHANGING GOALS AND TOOLS OF INDUSTRIAL POLICY

A key feature of Japanese industrial policy has been its flexibility in responding to changes in the domestic and international economies. During the early postwar period, industrial policies were geared toward achieving rapid economic growth and establishing an industrial infrastructure. As these goals were achieved, efforts were refocused on catching up with the industrialized West and developing new technology. By the mid-1970s, Japan was giving more recognition to such concerns as the quality of life, the environment, and other social considerations. Furthermore, the rapid rise in the price of petroleum since 1973 had an especially strong impact on Japan. Roughly 75 percent of Japan's energy comes from oil imports, the highest of any major industrialized nation. In the early postwar years, policy goals were primarily sector oriented; government and business addressed themselves to rebuilding specific industries and sectors of the economy. By the mid-1960s, Japan had largely achieved its postwar development goals and began placing growing emphasis on technology and social development issues. Following the economic turbulence of the early 1970s, Japan has focused on adjusting to stable growth, supporting resource conservation, and improving the environment, while continuing to support the development of new technology.

With changes in the goals of industrial policy, tools to implement these goals also changed. Such changes are attributed to numerous factors, including: The financial success of Japanese firms, which left them less dependent on debt financing; the relaxation of domestic regulation of financial markets, which opened new avenues of financing to firms; international pressure and obligations of Japan, such as those under the International Monetary Fund and the General Agreement of Tariffs and Trade; and Increasing budget deficits, which placed constraints on the government's ability to finance industrial development.

Government influence over key industrial sectors began to weaken as a result of these factors.

As trade investment laws were amended to remove controls over foreign exchange and international trade agreements provided for reductions in tariffs, quotas, and non-tariff barriers, the government lost a major source of its power to direct industry.

With increasing trade friction with developed nations, competition from newly industrializing countries, and economic hardships resulting from the oil crisis, the Japanese Government finds itself restraining competitive Japanese industries from foreign markets and assisting other industries to adjust to declining competitiveness. A rising class of structurally depressed industries, a number of which are energy-intensive, and the attendant employment problems have led to new legislation and government involvement in easing the adjustment process. In recent years, government deficits, high consumer and energy prices, and inflation have contributed to increasing difficulties in decisionmaking and in achieving consensus. As many of the postwar tools of industrial policy were lost to legislative or structural changes, administrative guidance grew in relative significance.

Today, the Ministry of International Trade and Industry continues to influence government and industry views concerning the direction of industrial development. As a result of the constraints and legislative and structural changes mentioned above, however, the Ministry has redefined the goals of industrial policy as (1) the need for Japan to move up the technological ladder in order to increase productivity and to promote conservation of resources and social goals and (2) the need to ease the adjustment problems, particularly unemployment, of certain declining industry sectors.

CURRENT INDUSTRIAL POLICIES TOWARD EXPANDING INDUSTRIES

The empasis of industrial policy today has shifted from industry-specific to technology-specific targets; industries are assisted in developing and diffusing technologies throughout the economy that contribute to achieving the goals of higher value added production, greater productivity, and resource conservation. Industries such as computers, robotics, and aircraft meet these criteria and benefit from government supoport.

Financial support for joint government-industry research and development programs is a major tool of government assistance for technology development, while tax incentives and special leasing programs are used to promote technology diffusion. These mechanisms work through incentive rather than control and, as a result, the government has less direct influence over industrial development than it had during earlier periods. Significant obstacles hamper the success of government policies in each growth industry we reviewed. Development of leading-edge computer technologies presents new risks for the government and computer companies. Problems encountered today in developing new technologies are different than those of licensing, adapting, and commercializing foreign technologies, which were successfully overcome during the last two decades. Robotics manfacturers face an as yet undefined and undeveloped market at home and abroad. They must develop new products as well as demonstrate applications in order to create demand for these products. The development of new aircraft and aircraft engines has become a task too costly for one company or one country to undertake, and Japanese companies, like those in other countries, need to participate in international joint ventures. It appears that the trend toward less direct government influence over industrial development may continue.

INDUSTRIAL POLICY TOWARD DECLINING INDUSTRIES

Rising labor costs, sluggish world demand, lower priced products from Southeast Asia, increased raw materials costs, and foreign market import restrictions have all contributed to severe economic disruptions for some Japanese industries. The government has attempted to assist these declining industries adjust to new circumstances by providing incentives to scrap excess production capacity. The government also assists workers in these industries through a number of unemployment and reemployment programs.

The Japanese Government has assisted troubled industries since the 1960's. The Structurally Depressed Industries Law, passed in 1978 and extended this year, addresses some generic problems of decline. Different mechanisms are used for short- and long-term problems. For example, a rationalization cartel, which permits member companies to jointly reduce output in order to stabilize prices, is used to address short-term price and production imbalances. Plant and equipment scrapping programs are aimed at long-term structural problems. The new law emphasizes the consolidation of business operations as well as disposal of excess capacity. The thrust of the government's current financial assistance, in the form of loans and preferential financing, is directed to small- and medium-sized firms. Larger firms are expected to adjust on their own and, in the case of the shipbuilding industry, to assume some of the burden of assistance to small- and medium-sized firms.

The Japanese Government, not unlike other representative democracies, has found that political reality often constrains the formation and implementation of economically rational decisions to phase industrial sectors out of the economy. Conflicts have arisen in setting priorities and implementing stabilization programs between government and industry and between firms within an industry. Nevertheless, adjustment of declining industries has occurred, although the long-term success of this adjustment process is unclear. Some effective mechanisms do exist for employment adjustment. Private industry takes the lead in retraining and outplacement. Historically, high growth rates and a variable labor force have helped to ease adjustment. In the slower growth environment, the government has become more involved in the adjustment process. Key elements of Japan's "positive adjustment" policy include (1) recognizing that emerging industries can ease the adjustment problems of declining industries and (2) coordinating programs to assist resource shifts from declining to emerging industries.

CONCLUSION

Macro- and microeconomic policies showed a high degree of complementarity during the early post-war period, which reflected the broad consensus to reindustrialize Japan. Japanese monetary and fiscal authorities intervened directly to develop and support industrial policies during this period.

Over time, changes have occurred. A key element of Japanese industrial policy has, therefore, been the flexibility of the government and its programs in responding to the pressures and constraints of the domestic and international economies. Government credit rationing is a less effective tool for directing the private sector, because Japanese companies have become financially stronger and alternate means of financing have become available to them. Debt financing has begun to decline, although it still accounts for a large proportion of total corporate funding in Japan. The city banks' dependence on Bank of Japan funds has begun to decrease as government-set interest rates move closer to those in the free market and as financial deregulation occurs. Increased budgetary deficits, coupled with increased difficulty in financing these deficits, have placed constraints on the government's ability to finance industrial development. As mentioned earlier, industrial policy now focuses on increasing productivity and promoting resource conservation and social goals, in part through enhancing technology, as well as easing adjustment problems of certain declining industries. The government's ability to direct the course and speed of industrial growth in light of an increasing number of conflicting priorities and legislative and structural changes in industrial policy tools is unclear.

YEN-DOLLAR EXCHANGE RATE

I would also like to touch briefly at this time on our current study of the yen-dollar exchange rate. Concerns that this rate has not reflected fundamental economic factors have generated charges that Japan manipulates the exchange rate of its currency to gain an unfair trade advantage. These charges have added to the tensions with Japan over other trade issues.

This concern over the yen-dollar exchange rate also comes at a time when many observers are raising questions about how well flexible exchange rates and the current international monetary system are working. Ten years ago, when the system was adopted, two widely held beliefs were that (1) flexible exchange rates would avoid sustained inappropriate currency values and (2) domestic economic policy formulation would be freed from the burden of international payments considerations. These propositions are being questioned today.

Although our work on these issues is continuing, we have reached several preliminary conclusions.

First, exchange rates in general cannot be adequately explained by looking only at international trade or specific bilateral relationships. Many variables, including the balance of trade, capital flows, and differences between countries' national economic policies and economic conditions, affect exchange rates. Unmeasurable factors, such as perceived political risks and expectations, also play a critical role. A consequence of these complex determinants is that foreign exchange markets can yield exchange rates that have adverse trade and employment consequences for us or for other nations at particular times.

Second, looking particularly at the yen-dollar exchange rate, we have seen no evidence to support charges that the Japanese Government manipulated or artificially depressed the value of the yen. On the contrary, Japanese foreign exchange intervention, together with other actions during this recent period, would tend to have strengthened rather than weakened the yen. The weakness of the yen and the strength of the dollar can be explained by a combination of variables, including high U.S. interest rates and liberalization of Japanese capital controls. The wide fluctuations in the yen and the low reached in November 1982, when the yen clearly "overshot" its equilibrium value, appear to be phenomena inherent in the nature of exchange markets.

Third, as international trade and investment have become much more important to the United States over the past decade, domestic ecomomic policies and exchange rates have become more dependent on each other. Domestic economic policy decisions affect exchange rates. At the same time, changes in exchange rates affect the policy's success in reaching goals, such as high employment or low inflation. Contrary to expectations, flexible exchange rates do not allow countries to pursue independent economic policies without considering the international consequences.

Finally, although currency fluctuations have created genuine problems and some observers have called for modifying the floating exchange rate system, there is no consensus as to what changes, if any, would be desirable and no agreement on what constitutes a better system.

Where a consensus does lie is in the recognition that domestic policy options in an open economy are more constrained than in a closed economy. Implementation of domestic economic policy without explicit recognition of the international constraints and cost of policies can be very disruptive to exchange markets and, in turn, can prove costly to the economy.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or your Subcommittee may have.

U.S. General Accounting Office,
Washington, D.C., May 11, 1983.

Hon. Sam M. Gibbons,
Chairman, Subcommittee on Trade, Committee on Ways and Means, House of Representatives, Washington, D.C.

Dear Mr. Chairman: As you requested in the hearings on April 26, we are providing you with additional clarification on Japan's Fiscal Investment and Loan Program (FILP). The attached chart shows FILP funding for fiscal year 1981 (Apr. 1, 1980 to Mar. 31, 1981). In that year, the amount of money in the FILP was equal to 41.7 percent of the amount in the General Account. We will submit for the record an update of the statistics in this chart with other information requested by the Subcommitee in the near future.

The majority of FILP funds come from the Ministry of Finance's Trust Fund Bureau Fund. The Trust Fund, in turn, consists of money from the postal savings system, welfare and national pension accounts, and other special accounts, which in fiscal year 1981 accounted for 46 percent, 20 percent, and 34 percent, respectively. Funds are also allocated to the FILP from postal life insurance and annuities accounts, government guaranteed bonds, borrowings from the private long-term credit banks, and a small amount from direct appropriations through the General Account.

Money in the FILP is allocated in three general categories—local governments, public investments, and policy implementation. Local governments use funds for public works, equity investment, and loans. Funds from the second category—public investments—go to institutions such as the Japan Housing Corporation, the Japanese National Railways, and four public highway corporations. Funds allocated in the policy implementation category flow through the Japan Development Bank, Japan Export-Import Bank, and three small business finance corporations in the form of equity investments and loans.

As we stated in our testimony, much of the country's personal savings are deposited in the postal savings system. In this system and in the city banks, interest earned on deposits up to 3 million yen is exempt from taxes; however, unlike city banks which compound annually, interest is compounded twice a year in the postal savings system. Moreover, with some 20,000 post office branches throughout Japan, this system has been a convenient one for individual depositors.

Should you have any further questions concerning the attached FILP chart, please contact us. We will be meeting with your staff in the near future to discuss the additional information requested during the hearings. We look forward to meeting with you to discuss our report in greater detail.

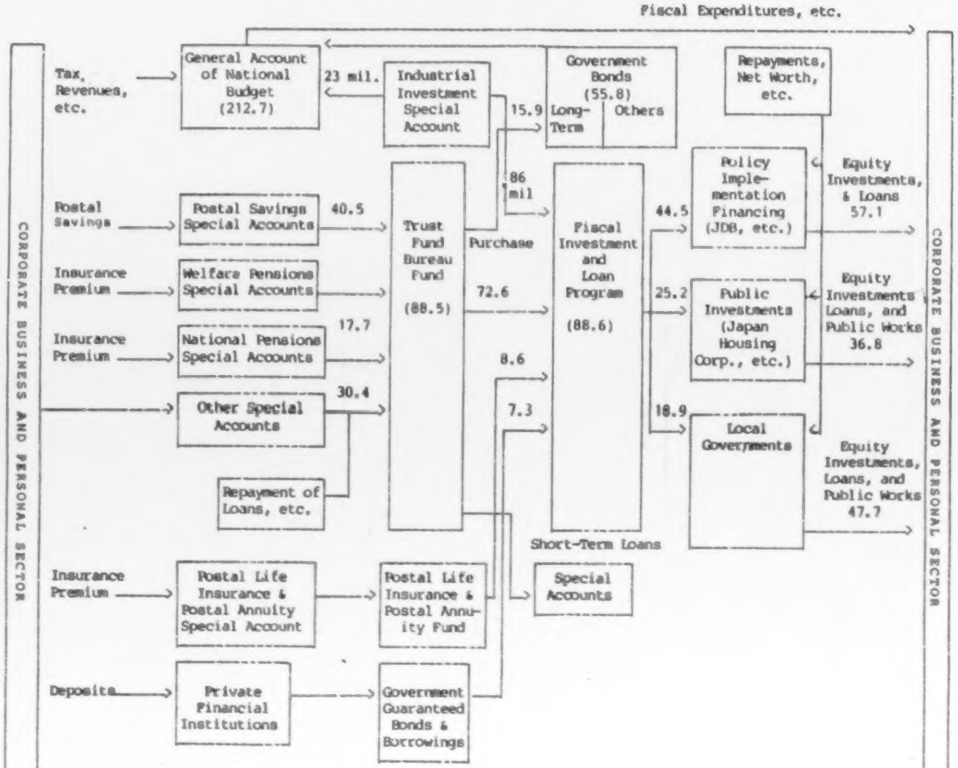
Sincerely,

FRANK C. CONAHAN, *Director.*

Attachment.

ATTACHMENT I

FISCAL INVESTMENT AND LOAN PROGRAM


Fiscal Expenditures, etc.
CORPORATE BUSINESS AND PERSONAL SECTOR
Tax, Revenues, etc.
General Account of National Budget (212.7)
23 mil.
Industrial Investment Special Account
15.9
Government Bonds (55.8)
Long-Term
Others
Repayments, Net Worth, etc.
86 mil
Postal Savings
Postal Savings Special Accounts
40.5
Trust Fund Bureau Fund (88.5)
Purchase
Fiscal Investment and Loan Program (88.6)
44.5
Policy Imple-mentation Financing (JDB, etc.)
Equity Investments, & Loans 57.1
Insurance Premium
Welfare Pensions Special Accounts
72.6
25.2
Public Investments (Japan Housing Corp., etc.)
Equity Investments Loans, and Public Works 36.8
Insurance Premium
National Pensions Special Accounts
17.7
8.6
Other Special Accounts
30.4
7.3
18.9
Local Governments
Equity Investments, Loans, and Public Works 47.7
Repayment of Loans, etc.
Short-Term Loans
Insurance Premium
Postal Life Insurance & Postal Annuity Special Account
Postal Life Insurance & Postal Annuity Fund
Special Accounts
Deposits
Private Financial Institutions
Government Guaranteed Bonds & Borrowings
CORPORATE BUSINESS AND PERSONAL SECTOR

NOTE: Figures based on initial budget of the program for fiscal year 1981.
Conversions at 220 yen = $1.00
Figures in billions of dollars unless otherwise noted.

Source: Japan Development Bank

Chairman GIBBONS. Well, you have obviously completed a very worthwhile study on industrial policy in Japan and it is one that I am going to sit down and read sometime when I am not bouncing along on an airplane.

Let me ask the two ladies who, as I understand, did most of the research work on this, how much government intervention is there in all of this process and does government intervention in this process amount to a bounty, as we generally understand a bounty to be, or a subsidy?

Would you care to expound on that?

Ms. MCGREGOR. I guess it depends on exactly how you are going to define it.

Chairman GIBBONS. First of all, would you identify yourself for the record.

Ms. MCGREGOR. Peggy McGregor.

There are certainly government subsidies going to Japanese industry. They are primarily focused in the R&D and diffusion areas.

Chairman GIBBONS. I am not talking about just the direct case. You are talking about direct case, is that right?

Ms. MCGREGOR. Yes. Beyond that?

Chairman GIBBONS. Yes, what else?

Ms. MCGREGOR. In addition, there is the consensus formation process where industry and labor and government get together and discuss the various aspects of projects that they should be or are going to undertake.

Chairman GIBBONS. How much of your research was done from Japanese literature and how much of it was done by investigation?

Ms. MCGREGOR. A small part of the research was Japanese source documents. We spent roughly 2 months in Japan doing an extensive amount of interviewing both with the Japanese Government, Japanese business, and U.S. business in Japan as well as U.S. business back here when we returned.

Chairman GIBBONS. Do you have anybody on your staff in GAO who speaks Japanese?

Ms. MCGREGOR. Yes, sir; I do.

Chairman GIBBONS. Good. You are unique in the Federal Government.

Let's look at credit in these industries. How do they get credit or infusion of capital?

Ms. MCGREGOR. Primarily through the 13 city banks. One of the points that I believe Ambassador Smith was making is that through the government targeting, various corporations are considered to be good risks. They obtain their capital through city banks in addition to subsidies that they obtain from the government.

Chairman GIBBONS. Could you pull that microphone over closer to you? People in the back of the room are having a hard time hearing you.

That is a bad mike. We are going to buy them from the Japanese the next time. Just get real close to it there. Do it like Frank Sinatra does. He sort of gets real close to the mike.

Ms. MCGREGOR. They do obtain it through the 13 city banks. Beyond that there are also funds that are obtained from the JDB. When I was talking about the subsidies to the extent that the JDB makes loans for various projects, the 13 city banks are aware of which companies these loans from the JDB have gone to and in the process decided, obviously, that these companies are a good risk.

Chairman GIBBONS. What do the 13 city banks get most of their deposits?

Ms. VUICICH. From business. Some of their loanable capital comes from the Bank of Japan. They also receive some deposits from companies and from individual savers.

Chairman GIBBONS. Doesn't most of the capital of those 13 city banks come from the postal savings personal savings system?

Ms. VUICICH. Most of the personal savings is in the postal savings system.

Chairman GIBBONS. And who controls that?

Ms. VUICICH. That goes through the Ministry of Finance into what is known as the Trust Fund Bureau Fund.

Chairman GIBBONS. So, in effect, the Government of Japan really is providing the capital for the 13 banks. In effect they supply most of the capital, don't they?

Ms. MCGREGOR. Not the personal savings. They are two separate situations. The postal savings system, in which the large majority of Japanese citizens deposit their savings, is managed by the Ministry of Post and Telecommunications and Finance. It is allocated through the Trust Fund Bureau, of the Ministry of Finance to the Japan Development Bank and several other institutions for various government-prioritized projects and goals. That is separate from money obtained by the city banks.

There are personal savings in the city banks as well, not to the same extent that there exist in the postal savings system, however.

Chairman GIBBONS. Aren't the deposits in the postal savings system largely redeposited in those 13 banks?

Ms. VUICICH. That money goes through what is known as the fiscal investment and loan program which has totaled as much as 50 percent of the general account. That money is spent by the government to meet whatever goals it has set out for itself. To the extent that it is spent by the government and then works its way back into the city banks, it is an indirect flow of funds.

Chairman GIBBONS. Let me tell you what my feeling is. My feeling is that the Government of Japan, through the postal savings system in which most Japanese are forced to save, in turn funnels that money back to the 13 city banks and the 13 city banks get a vision from MITI as to where that money ought to be lent and that is the subsidy.

Now, am I wrong?

Ms. MCGREGOR. The effect may not be different from what you are saying, however, the actual process is, that the postal savings system, where individual savers deposit their savings, is managed by the Ministries of Finance and Post and Telecommunications which then goes on to the trust fund and the fiscal investment and loan program.

The trust fund is broken up and allocated by the Japanese Government to various special government banks such as the Japan Development Bank, the People's Finance Corporation, and so on.

Those banks then make loans to various industries on the basis of various priorities and goals that the government has set. In that sense the JDB, for example, can make a loan to the Japanese computer industry for whatever amount for the VLSI project or the next generation computer project.

Chairman GIBBONS. And aren't some of these loans nonrecourse programs and by that I mean loans that don't have to be repaid if the project doesn't succeed?

Ms. MCGREGOR. That is correct. Some of them are success conditional.

Chairman GIBBONS. Do you know of any countervailing duty cases that have been brought by U.S. companies alleging that this in practice is a subsidy?

Ms. MCGREGOR. I am not aware of that.

Mr. BERNGARTT. Not that we are aware of, no. We do have underway currently an assignment that deals with the subsidy code and we would hope in the next 1 or 2 months to have a draft report on that.

Chairman GIBBONS. In your investigation of Japanese industrial policy, did you find any government policy that preferred buy Japanese policy for these targeted industries?

Ms. VUICICH. In the computer industry certainly there has been a policy of buy Japanese. That practice has been officially rescinded by a cabinet order.

Chairman GIBBONS. How long did it last before they rescinded it?

Ms. VUICICH. The industry had its beginnings in the 1950's and I believe it was rescinded in the late seventies, about 25 years.

Chairman GIBBONS. At the same time they excluded U.S. computer industries from their country and made it very difficult for U.S. concerns except somehow Texas Instruments got in. I don't know how they did it.

Mr. FRENZEL. They needed them.

Chairman GIBBONS. I don't want to monopolize this discussion. I will probably come back and talk to you after I finish reading your study.

Mr. Frenzel?

Mr. FRENZEL. I wasn't sure about the money train that Mr. Gibbons was tracing and I wasn't sure whether you were endorsing his description of it.

Do you have in your study some sort of diagram or chart flow of savings in Japan and where they go and how they are allocated?

Ms. VUICICH. We have a narrative. I think there may be one chart in there.

Mr. FRENZEL. Well, would you restate so that I would understand your answer to Mr. Gibbons' question and that is, do the savings——

Mr. BERNGARTT. That is on page 31. Excuse me for interrupting but that is on page 31 of our report.

Mr. FRENZEL. I expect I will get that whenever the mail comes by.

Does the savings from the personal program through the post offices find its way into the 13 city banks and is it directed to industries favored by MITI for expansion?

Ms. MCGREGOR. It is directed to industries. It does not directly find its way into the 13 city banks. It is directed to industry.

Mr. FRENZEL. Where does it go?

Ms. McGregor. It goes from the Ministry of Finance on the basis of MITI and government——

Mr. Frenzel. Well, first, it goes to the post office. Is it then in the hands of the Ministry of Finance? Does Finance run the post office?

Ms. McGregor. At that time it is in the hands of the Ministry of Postal and Telecommunications. The Ministry of Finance then takes that and it is distributed through the fiscal investment and loan program into various different Japanese Government banks such as the People's Finance Corporation, the Japan Development Bank, and so on.

Through those banks it then finds its way into Japanese industry. The Japan Development Bank, on the basis of a set of goals and priorities that it has established through consultations within the Government, allocates that money to various industries. It can be for technology development, regional development, any number of different areas which the bank has determined are priorities.

Mr. Frenzel. On your chart are those numbers in billions of dollars?

Ms. Vuicich. Billions of yen.

Mr. Frenzel. Can you do the conversion for me for dollars of postal savings? Can you divide by 237? I guess I can.

Ms. Vuicich. I am sorry.

Mr. Frenzel. What is the individual savings in the postal system annually? Is it 8 or almost 9 billion yen? Is that all it amounts to?

Ms. Vuicich. I think that the estimate that we use, and this will not give you an absolute figure but this whole program usually amounts to 40 or 50 percent of the amount in the entire budget in the country. That would give you some idea of the relative magnitude.

Mr. Frenzel. The postal savings account amounts to 50 percent of the Japanese national budget?

Ms. McGregor. Not the postal savings account, the fiscal investment and loan program which is considered a second budget in Japan. It is sort of their slush fund budget, I guess. It is roughly 50 percent of the general account budget which is the budget that is generally spoken of.

Mr. Jones. Would the gentleman yield on that?

Mr. Frenzel. Of course.

Mr. Jones. Does that all come from the savings?

Ms. McGregor. No.

Mr. Jones. Where does it come from?

Ms. McGregor. The largest share of the fiscal investment and loan program is from postal savings. It is also from welfare and pensions insurance and so on. So there are other smaller programs that are involved with the fiscal investment and loan program.

Mr. Jones. What are they getting from welfare?

Ms. McGregor. It looks like 3 trillion.

Mr. Berngartt. Welfare and pensions are combined.

Ms. McGregor. It is about 3.9 trillion.

Mr. Frenzel. But the numbers are too little?

Ms. McGregor. Four trillion.

Mr. Frenzel. Well, the postal savings of 9 billion yen is not near enough, nor is the welfare pension special account and the national pension special account, 4 trillion yen, enough money.

Is that meant to be just a proportion or something?

Ms. McGregor. No, that is simply the amount in those accounts.

Mr. Frenzel. It is the amount you found in those accounts. It is not an annual figure?

Ms. McGregor. It is an annual figure for 1981.

Mr. Jones. That wouldn't be 50 percent of their regular budget, 9 billion yen?

Ms. Vuicich. No, of this entire fiscal and investment loan program of which that is a small part. There are also a number of government bonds included in that.

Ms. McGregor. There is an industry investment special account that is included in that.

Chairman Gibbons. Obviously, the whole thing is that we have to study the way they carry this thing out more closely before we can understand it. It is not that they have tried to hide anything from us. Let me make that clear. They haven't tried to hide anything from us. It is all pretty much on the record but we haven't been very good and studying the record.

Mr. Frenzel. Mr. Chairman, we need to get better numbers. Nine trillion yen is lots of yen but it is only $40 billion.

Chairman Gibbons. It is not in dollars.

Mr. Frenzel. They probably save that every day.

Mr. Berngartt. Well, why don't we go back and look at this and then submit something for the record in dollars?

Mr. Frenzel. Why don't you? These are 1981 figures which are the most recent that you have.

Ms. McGregor. Yes.

Mr. Frenzel. Why don't you take a look at that and see if you can get back to us.

Chairman Gibbons. Isn't the gist of all of this that there is a pretty heavy government intervention one way or another through the savings system into their whole operation?

Ms. McGregor. To the extent that the savings are deposited in the postal savings system which makes its way into the fiscal investment and loan program which then makes its way to the Japan Development Bank and so on, yes.

Chairman Gibbons. So, in effect, what we are running into is a government that is taking a very large capital infusion or loan infusion into the private business sector through some sort of subsidized savings process, some sort of subsidized capital program.

Now, I don't want to overstate the case or misstate it. I will try to draw some conclusions.

Ms. Vuicich. One of the things that we point out in the report is that the government has, indeed, historically anyway, channeled most of the savings into productive investment. That can be in the form of loans to regional governments which then use it for public works projects or any number of things.

So I think what you are saying is true. They have spent this money after agreeing upon goals as to what they are going to achieve by spending it and for the most part it has been for productive investment purposes.

Chairman **Gibbons**. As a part of the targeting operation?

Ms. **Vuicich**. Yes.

Mr. **Frenzel**. Do you know very much about the postal savings accounts? Do you know what the rate of return is?

Ms. **McGregor**. I am not sure what it is.

Mr. **Frenzel**. As I understand it, it is rather low by U.S. standards. Of course, that is not unusual. Every deterrent in the world is low by U.S. standards.

I understand also that the deterrent on it is a confidential amount and that up to a certain number of yen it is tax free; is that correct?

Ms. **McGregor**. That is correct.

Mr. **Frenzel**. Do you now how many yen you get tax free out of that?

Ms. **McGregor**. I believe it is 3 million yen.

Mr. **Frenzel**. Three million deposit or 3 million interest?

Ms. **McGregor**. Deposit. Interest on a deposit up to 3 million yen is tax-free.

Mr. **Frenzel**. Annually?

Ms. **McGregor**. No, a deposit.

Mr. **Frenzel**. A total deposit of 3 million yen draws tax free interest. Now, can you go to the next post office down the street and throw another 3 million in?

Ms. **McGregor**. I don't know if you have already deposited in one post office if you, using the same name, can go to the next post office but I believe that you can set up an account in the next post office in your wife's name, your son's name or your daughter's name.

Mr. **Frenzel**. Thank you very much.

Chairman **Gibbons**. Mr. Pease.

Mr. **Pease**. I would like to just ask a little more about these city banks. What is the source of funds for the city banks? Where do they get their money?

Ms. **Vuicich**. Corporate deposits, to some extent individual deposits, and from the Bank of Japan.

Mr. **Pease**. Do you have any idea what percentage of the assets or loanable funds of the city banks come from the Bank of Japan?

Ms. **Vuicich**. We will be happy to provide that for the record.

Mr. **Pease**. The Bank of Japan is different from the Japan Development Bank, right?

Ms. **Vuicich**. Yes. The Bank of Japan is the central bank.

Mr. **Pease**. And are the city banks a major source of capital for Japanese industry?

Ms. **Vuicich**. Yes.

Mr. **Pease**. Do you have any indication that the distribution of loans is subject to government policy targeted in any way by the city banks?

Ms. **McGregor**. We have no direct evidence of that. However, in conversations that we had with representatives of the banks in Japan, their perspective was that investing in a company that was receiving government funds for a targeted program or something along those lines was quite obviously, in their view, a very wise investment. We have no evidence to indicate that the government told them to invest in that fashion.

This perception was simply that it was a wise investment on their part.

Mr. PEASE. Mr. Chairman, I think that is a very valuable point and it corroborates the point that I was tryng to make while we were in Japan.

Even if the government does not direct these 13 city banks to loan money to company *X* or company *Y*, if the banks exercising prudence in managing the funds of their depositors realize that certain industries have been anointed and that certain companies are operating within those anointed industries they would certainly be wise to loan money to those companies to the extent possible.

And you have found some corroboration for that in your discussions with banking officials?

Ms. MCGREGOR. Yes.

Mr. PEASE. Thank you very much.

Chairman GIBBONS. You know I think it goes further than that. I think they don't get the deposits unless they make the right loan. Did you find any evidence of that?

They don't get the deposits from the government unless they make the right loans?

Ms. VUICICH. Each city bank has a quota of loans that comes from the Bank of Japan which may be adjusted.

Chairman GIBBONS. Yes.

So if you are interested in lending the money to the right people you get the deposits. If you are not interested in lending the money to the right people you don't get the deposits. Therefore, you are very interested in lending the money to the right people.

Mr. PEASE. Could I ask further, is the interest rate for depositors different than what it is for the postal system?

Ms. MCGREGOR. Yes.

Mr. PEASE. Higher or lower?

Ms. MCGREGOR. I believe it is higher, although these have fluctuated over time.

Mr. PEASE. The city bank interest rate is lower as paid to depositors?

Chairman GIBBONS. So where would you put your money?

Mr. FRENZEL. It is limited, of course.

Chairman GIBBONS. Oh, yes.

Mr. PEASE. Is the interest tax free from city banks as well?

Ms. MCGREGOR. Yes.

Mr. PEASE. On an equal basis with the postal system?

Ms. MCGREGOR. My understanding is that it is.

Mr. PEASE. But the rate differential would certainly still encourage you to put it in the postal system?

Ms. VUICICH. Another point is that the postal savings system has been very convenient because there are so many branches.

Mr. PEASE. What about the interest rates that are charged to industrial borrowers? Do they vary as between the Japan Development Bank, for example, and the city banks?

Ms. MCGREGOR. The Japan Development Bank loans are primarily made at or near the prime. There is a differential between that and the city bank loans.

Mr. PEASE. Would the city bank loans be more expensive? Would they have a higher interest rate or lower interest rate?

Ms. McGregor. Slightly higher, I believe.

Mr. Pease. City banks are slightly higher?

Ms. McGregor. Yes.

Mr. Pease. Finally, let me ask you about the success contingent loans. They are made by the Japan Development Bank, is that right?

Ms. McGregor. No, they are made directly by the Government.

Mr. Pease. Are they also made by the city banks?

Ms. McGregor. Not that I am aware of, no.

Mr. Pease. Do you have any idea of what percentage of the portfolio of the Japan Development Banks is in success contingent loans?

Ms. McGregor. No, sir. We will try and check into it and provide it for the record.

Mr. Pease. Thank you very much.

Mr. Jones. Mr. Chairman, I won't take long because I have not seen your report yet and I will read it first before I get into budget questions, but I think the line of questioning that has developed here is a very important one that could contribute to the knowledge of the Congress and others about how the system works in Japan.

Perhaps a number of the questions that were thrown at you were unexpected and I sense there were tentative answers to those, so I won't accept them totally. But I think it would be very worthwhile if you would go into this system of the deposits, for example, I would like to see the comparisons in the two countries, the postal system savings and its ultimately loaning out to development banks. What direct comparisons would there be between that and the social security system here that has so many restrictions on how that money can be used and what kind of protections there are for those who save in the postal system. Presumably if that money ultimately finds its way into the hands of some losers, somebody has to absorb those losses.

Who absorbs those losses and how is that done? I would like a greater explanation of how they operate their savings and money system.

The second thing, does your report get into how they determine the winners and losers in this industrial policy? In other words, obviously this is a Government decision but is there a mechanism, formal or informal, that sits down and says, OK, aviation is the thing.

We are going to put *x* amount of resources into it over this given period of time and we are going to marshal all these other resources to do it. What is the mechanism and is there anything we can learn from that? Does your report get into that?

Ms. McGregor. It does. In fact, I think one of the things that we try to state in the report is that in our view the Japanese Government doesn't, in fact, try to pick the winners and losers. We see the process at little bit differently than that.

The way we view the process is that the Government, through various Government industry, labor, scientific conventions and so on, attempts to set a series of priorities and specified goals in terms of development of the economy.

In setting those goals they establish basic policies to encourage economic development. For example, right now they are talking about higher value added production, high technology, and so on. Fallout from those goals is that specific industries become targeted. I think this is an important point—that they are not picking a winning industry or a losing industry.

They are trying to set overall goals with the idea that once goals are set industries to be targeted fallout automatically. The government money going in for support of these goals can affect and find its way into a broad range of industries.

I believe we have a chart in the report which shows that for the next generation industries programs that there are a broad range of industries receiving and involved in the Government programs. They range from computer firms all the way to glass and brick firms as well.

Mr. JONES. Well, did they have regional meetings? Is anything formally structured in this? Do they have a convention and say, this will be our goal-setting convention?

Ms. MCGREGOR. There are several formal processes that do exist. The first and primary one is through the Economic Planning Agency where, in a sense, a general framework for the country is set. When you get down to I think what you are probably more interested in, the more micro level, there is an Industrial Structure Council which functions and does more micro level planning with a view toward how MITI should be directing its funds, how are they going to support overall national goals and so on.

Mr. JONES. I would be interested in your report but I would be interested to see your recommendations on the pluses and minuses of, say, using the social security trust fund, a portion of that to finance a national development bank that provides capital to industries as a result of a similar kind of process that sets economic goals for the country here in the United States.

Thank you, Mr. Chairman.

Chairman GIBBONS. Well, I want to commend you all for starting this operation and looking very closely at how the system works there. It is obvious from our questions this morning that we don't clearly understand what they do and, as I say, that is no reflection on the Japanese. They printed most of this material. We just haven't read it.

But it looks to me as if targeting is a much more serious problem than we have anticipated. As I have assured the Japanese, if there is no subsidy then they don't need to worry about it. If there is a subsidy then they can begin to worry about it.

I frankly am going to be looking very closely at how it works to make sure that we make it as unattractive to subsidize as possible.

So your work is very important work and any followup you can do on it would be very helpful.

We would perhaps like to sit down with you privately and discuss any particular leads you can get.

I personally think that targeting sort of evolved as a survival mechanism from World War II and as the evolution took place in targeting it has become a tool for industrial expansion. That expansion takes on in some cases and in some industries the form of a subsidy or bounty which we, as well as the Japanese, have all agreed is not fair in protection trade practices.

So I want to enforce the general agreement on the subsidies code and our own laws against that.

As I say, if there is no subsidy, they can sleep well. If there is a subsidy they had better begin to find out where it is and tame it down so that it complies with the General Agreement on Tariffs and Trade and complies with our own laws on subsidies.

Thank you all very much.

Ms. **McGregor**. Thank you, Mr. Chairman.

Mr. **Berngartt**. Thank you.

[The following was subsequently received:]

GAO Responses to Additional Questions

Japan's Saving System

1. What is the relationship between the Ministry of Finance and the Post Office? What is the nature of the Finance Ministry's control over funds in the postal savings system?

   The Ministry of Post and Telecommunications has responsibility for the post office system in Japan and, with the Ministry of Finance, sets interest rates in the postal savings system. Savings deposited in this system are placed in the Ministry of Finance's Trust Fund Bureau Fund. The Ministry allocates these deposits to the Fiscal Investment and Loan Program (FILP). Through the FILP, these funds flow to government banks and corporations and in some cases are then allocated to industries.

2. What is the magnitude of individual savings flowing into the postal system annually?

   Annual deposits in 1981 amounted to $40.5 billion, and in 1982 were $33.3 billion.[1] As of 1982, all personal savings deposited in the postal savings system totalled $289 billion.

3. What is the size and source of funds of the Fiscal Investment and Loan Program?

   As we noted in our letter to the Chairman (dated May 11, 1983) funds in the FILP come from numerous sources - e.g. - postal savings, welfare pensions, national pensions, postal life insurance, the Industrial Investment Special Accounts and government guaranteed bonds and borrowings. Our most recent figures show that in 1982 the FILP amounted to $100.37 billion.

4. What is the rate of return on postal savings accounts?

   As of February 1983, interest rates in the postal savings system were 3.12 percent for ordinary savings, 4.25 percent for savings certificates under one year and 5.75 percent for certificates over two years.

5. What restrictions exist on individual accounts?

   Beyond the time restrictions stated above, we are not aware of any restrictions on postal savings accounts. However, the amount of interest earned on accounts of roughly $12,600 is tax-free.

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[1] For 1981 exchange rate conversions 220 yen=$1.00; 1982 exchange rate conversions 237 yen=$1.00.

A "green card" identification system to prevent account duplication and tax avoidance was scheduled to go into effect on January 1, 1983. The Japanese Diet, however, voted to postpone implementation; and indications presently are that the system will not go into effect.

City Banks

1. What percentage of their assets or loanable funds come from the Bank of Japan?

Borrowings of city banks from the Bank of Japan as a percent of city bank liabilities were as follows:

1975	1.8%	1979	1.43%
1976	1.78%	1980	1.46%
1977	1.82%	1981	0.82%
1978	1.99%		

Dependence of the city banks on the Bank of Japan for funds has declined gradually since the 1960s when it reached a high of 12.3% in 1961.

2. What is the rate of return for depositors? What, if any, portion of interest is tax free?

Interest rates on deposits in city banks as of February 1983 were as follows:

Checking accounts - no interest

Ordinary deposits - 1.75%

6 month certificates - 5.00%

1 year certificates - 5.75%

As with the postal savings system, interest on deposits up to approximately $12,600 is tax free.

3. What interest rate is charged on loans to industrial borrowers?

Interest rates on loans to borrowers vary, and as of 1980 the maximum rates were:

--standard rate on high quality commercial bills and loans:
.25% above official discount rate.

--on other bills and loans:
2.0% above official discount rate.

--temporary overdraft rate:
3.0% above official discount rate.

As of February 1983, the official discount rate on commercial bills, and loans secured by government bonds was 5.5 percent. The average rate on all bank loans was 7.1 percent.

In addition, city banks have traditionally required borrowers to hold part of any loan on account with the bank as a compensating balance, thereby effectively raising the cost of any loan.

Japan Development Bank

1. What percentage of the portfolio of the JDB is in success-conditional loans?

   The Japan Development Bank does not give success-conditional loans. Interest rates on JDB loans range from 7.3-8.4 percent and terms are from 1-30 years.

   Success-conditional loans are made by other agencies, e.g., MITI. We do not have information on the aggregate volume of success-conditional loans to industry.

U.S.-Japan Comparison

1. Please explain the operation of the Japanese saving and money system in detail.

   In general, the government in Japan plays an important role as a financial intermediator. Our report traces the historical development of Japan's money system focusing particularly on credit rationing as a tool of industrial policy. Chapter 2 contains a detailed discussion of the operation of this system.

2. Compare Japan's system of deposits, its postal savings system and ultimate loans to the U.S. Social Security System. Are there restrictions on use of money or protection for those who save in the postal savings system in case of losses? Who absorbs losses in the Japanese system and how is that absorption managed?

   The U.S. social security system is a "pay as you go" system, financed through a tax on wages. Because of a complex system of adjustments, contributions to the system bear little relationship to what one receives in payments. Money from the Social Security Trust Fund can be used only to pay benefits. On the other hand, in the Japanese postal savings system receipts are equal to deposits plus accrued interest and participation is voluntary. The money which is held in the Trust Fund Bureau Fund is loaned for a number of purposes.

A comparison may be made between the postal savings system in Japan and U.S. savings and loan institutions. In this instance, a striking difference exists in that the Japanese system subsidizes savers through its tax treatment of interest income, while the U.S. system subsidizes borrowers in its tax treatment of interest paid on loans.

There is no protection of funds in the postal savings or city bank systems from losses, similar to that of the Federal Deposit Insurance Corporation in the United States. However, we understand that there has never been a bank failure in Japan. Thus, the same importance is not attached to such protection in Japan as in the United States.

3. Give your recommendations on the pluses and minuses of using a portion of the Social Security Trust Fund to finance a national development bank to provide capital to industries. Could there be a process in the United States similar to that in Japan which would set economic goals?

The use of social security trust funds for purposes other than paying benefits is possible only when a reserve or surplus exists. For the period of time when contributions to the Trust Fund did exceed disbursements, the excess money entered the federal government's flow of general revenues and was used, for the most part, to finance ordinary operations of the government. Should the Congress and the Executive decide to establish such a priority, presumably any future surplus could be used to fund a national development bank. Other United States institutions may also provide comparisons. For example, the National Cooperative Bank was set up with federal funds to finance cooperative business enterprises and the Federal Financing Bank, was established to, inter alia, coordinate the government's borrowing programs with overall economic and fiscal policies. The Bank has obtained funds from issuing its own securities or borrowings from the Department of the Treasury.

The planning process in Japan has developed over a number of years. A key feature of the Japanese process is the integration of domestic and international policies, which for the most part doesn't seem to readily occur in the United States. Although the United States has no directly comparable mechanisms, some similarities are evident in groups such as private sector advisory committees and industry sector advisory committees, the President's Export Council, the Labor Industry Coalition for International Trade and so on.

Chairman GIBBONS. Let me ask the committee what you want to do. Here again, we are running out of time because this testimony is so very important and very interesting. I will come back at 1 o'clock if anybody else can join me.

All right. We will recess until 1 o'clock.

[Whereupon, at 12:10 p.m., the hearing was recessed, to reconvene at 1 p.m.]

AFTERNOON SESSION

Chairman GIBBONS. Our next group of witnesses will be from the National Machine Tool Builders' Association. Mr. Howe, accompanied by Mr. James H. Mack.

Mr. Howe, it was nice to meet you earlier. Just proceed as you wish.

STATEMENT OF NATHANIEL S. HOWE, SENIOR VICE PRESIDENT, LITTON INDUSTRIES, INC., ON BEHALF OF THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION, ACCOMPANIED BY JAMES H. MACK, PUBLIC AFFAIRS DIRECTOR

Mr. HOWE. Thank you, Mr. Chairman.

My name is Nathaniel Howe. I am the senior vice president of Litton Industries, Inc., in Hartford, Conn. I am chairman of the National Machine Tool Builders' Association, on whose behalf I am appearing this morning. Accompanying me today is James H. Mack, NMTBA's public affairs director.

On March 10, 1983, NMTBA filed a petition with the Secretary of Commerce seeking trade relief in the form of quotas upon metalcutting and metalforming machine tools imported into the United States.

Today, our industry is faced with a full-scale depression. New orders have fallen by 84 percent in just 3 years. Existing plans and production equipment have been shut down, and tens of thousands of skilled production workers have been laid off.

In addition, there has been a recent massive increase in the share of the domestic market held by imported machine tools. Imports' share of the domestic market for 1982 was approximately 27 percent, measure by value, or 44 percent, measured by units, and is growing. About half these imports come from Japan.

When the demand for machine tools revives, it is likely to be supplied initially, in major part, from enormous quantities of Japanese machine tools warehoused in this country and abroad, and the figure covering that is something ranging beyond 3,000 sophisticated machine tools.

The Japanese Government has followed an industrial policy of targeting the high technology growth segment of the machine tool industry for dominance by giving special governmental assistance to Japanese manufacturers and by encouraging their cartelization.

As a consequence, Japanese imports of NC machine tools account for more than 50 percent of the value of current domestic consumption in this category and more than 70 percent of the units.

Despite these facts, the administration last Friday turned down the petition filed almost 1 year ago by one of our members, Houdaille Industries, who sought to restore equity and balance to

United States-Japanese trade relations by punishing the patently unfair trade practices of the Japanese.

Granting the extremely well-documented Houdaille petition would have been an important first step to saving two critical segments of the U.S. machine tool industry from being overrun by a relentless tide of subsidized Japanese NC machine tools.

The rationale for turning the other cheek to proven Japanese targeting practices escapes us. It is, in our judgment, precisely the wrong signal to send to our forgotten trading partners, who now know that they can target critical U.S. industries for extinction without fear of reprisal by the U.S. Government.

It is the wrong signal to send to American victims of Japanese targeting, who must by mystified by the Reagan administration's refusal to stand up to the juggernaut of subsidized imports, even when the unfair trade practices of their foreign competitors are well-established and generally accepted within the administration.

And it is the wrong signal to send to this committee, the leadership of which had urged approval of the well-documented Houdaille petition. Last December, the full Senate endorsed the petition.

I would have to add here that decisions like this, as you stated this morning, Mr. Chairman, breed cynicism for the facts were clear, and as you have suggested earlier, the law should have been enforced.

In light of the apparent inability of both the Reagan and Carter administrations to positively exercise discretion in the face of proven facts, this committee should give serious consideration to reasserting congressional authority to determine the consequences of unfair foreign trade practices, such as those documented in the Houdaille petition.

We are hopeful that USTR will be able to convince the Japanese to stop their unfair practices. But our national security cannot be based on the naive hope that others will put an end to decades of unfair subsidies and cartels, any more that it can be based on the naive hope that the Soviets will suddenly change their military policies. Positive action is required.

The national security of the United States is clearly being impaired by current levels of machine tool imports. These imports threaten to debilitate the domestic machine tool industry, which is critical to the U.S. defense and deterrence posture.

Section 232, the National Security Clause of the U.S. Trade Laws, requires that the President take steps to adjust imports downward to a level that does not threaten to impair the national security, regardless of whether unfair trade practices are involved.

Section 232 is a fundamental part of the Nation's defense and trade policy. Congress conceived section 232 as a potent remedy and has since strengthened and broadened its provisions.

A careful reading of the committee reports and floor debates surrounding congressional adoption of section 232 and its predecessors impel one to the conclusion that the machine tool industry is one which Congress had in mind when it passed the National Security Clause.

Although the machine tool industry is small, it is critically—indeed, uniquely—important for national defense. The products and technology of our industry are the essence of the industrial manufacturing process.

They are, by definition, the "tools" of production. Machine tools are needed to produce every ship, plane, tank, missile, transport vehicle, and other armament used by our Armed Forces, as well as essential elements of the supporting civilian infrastructure.

A protracted large-scale conventional war would drastically increase the demand for machine tools in the United States. At the same time, it would disrupt sea lanes linking the United States with Europe and Japan and would present a grave risk that the production from Japanese and other overseas machine tool factories would be denied to the United States either as a result of hostile military occupation, attack, or intimidation, or as a result of dedication to the defense needs of the country in which the factories are located.

Unless one wishes to ignore the possibility of a large-scale conventional war, the United States simply cannot tolerate the displacement to Japan of its domestic machine tool production capacity.

However, we are in serious danger of that displacement occurring unless our national security petition is granted. Our written statement documentes that peril in vivid detail.

Japan has no legitimate objection to our petition. Japan has already used the National Security Clause to limit agricultural imports. Since the American industrial base is an important factor in the deterrence of war, our principal trading partners, in their own self-interest, should be prepared to accept the very modest burden required to strengthen that base.

Japan spends a very low percentage of GNP on its own defense and thus gets a free ride from the American defense and deterrent capability.

In summary, the importation of machine tools in present quantities and under present circumstances impairs the national security. It follows, under the national security clause, that action must be taken through the imposition of quotas.

The granting of this relief will induce additional investment in new domestic production capacity that will reduce the gap between existing capacity and mobilization needs.

Equally important, this investment will restore the U.S. industry's vigor and protect its status as a leader in high technology applications.

Thank you. I would be very pleased to answer some questions.

[The prepared statement follows. Oral testimony continues on p. 447.]

STATEMENT OF NATHANIEL S. HOWE, SENIOR VICE PRESIDENT, LITTON INDUSTRIES, INC., AND GROUP EXECUTIVE, MACHINE TOOL SYSTEMS GROUP, REPRESENTING THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

I. INTRODUCTION

Good morning, my name is Nathaniel S. Howe. I am the Senior Vice President of Litton Industries, Inc., in Hartford, Connecticut. I am Chairman of the National Machine Tool Builders' Association (NMTBA), on whose behalf I am appearing this morning. Accompanying me today is James H. Mack, NMTBA's Public Affairs Director.

NMTBA is a trade association consisting of over 287 American machine tool manufacturing companies, which produce approximately 85 percent of the machine tools made in the United States. On March 10, 1983, NMTBA filed a petition with the Secretary of Commerce seeking trade relief in the form of quotas upon metal-cutting and metal-forming machine tools imported into the United States. More specifically, NMTBA requests a five-year regime of quotas limiting imports in each of the two broad sectors of machine tools to 17.5% of domestic consumption, measured by value. To preserve the domestic industry's capability to produce the complete range of major types of machine tools, NMTBA further requests that separate quotas be applied within these broad sectors so that imports of specific types of machine tools cannot exceed twenty percent of annual domestic consumption of each of 18 product types. In establishing and applying the quotas, care must be taken to ensure that they cannot be circumvented by the importation of unassembled machine tools or component parts in quantities that would effectively undermine the relief granted.

NMTBA also suggests that the government may wish to consider implementing the quotas on a monthly or quarterly basis to minimize the risk that foreign producers will disrupt the market by shipping a full year's quota to the United States early in the year. Imports of machine tools of one or more of the 18 product types would be permitted at levels between 17.5 percent and 20 percent of domestic consumption so long as the level of imports of other types was less than 17.5 percent of domestic consumption, provided that the sales-weighted average value of imports did not exceed 17.5 percent of domestic consumption in either the metal-cutting or the metal-forming sector.

These levels of quotas are intended to achieve specific national security objectives -- restoration of the health of the domestic machine tool industry and expansion of its mobilization capability -- as discussed below. The quotas are expressed in terms of value, instead of units, to prevent foreign producers from effectively increasing their market share by concentrating their shipments to the United States in the highest-priced models.[1] It should be noted, however, that the quotas requested do not confine importers to any fixed dollar value of imports during the five-year period. Instead, they would allow importers to participate proportionately in any increase in U.S. consumption of machine tools.

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[1] Should it be proposed instead that the quotas be expressed in terms of units, it would be appropriate to divide the permitted number of units into different value categories.

Our Petition is addressed in the first instance to the Secretary of Commerce, who has a statutory duty to inform the President whenever he "finds that [an] article is being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security." 19 U.S.C. § 1862(b) (Supp. V 1981). The Petition is addressed ultimately to the President, who has the obligation, if he agrees with such a finding by the Secretary of Commerce, to "take such action, and for such time, as he deems necessary to adjust the imports of such article . . . so that such imports will not threaten to impair the national security." Id.

In view of the national security considerations discussed in our Petition, the Government's review should proceed expeditiously and should not await completion of the International Trade Commission's pending investigation of the domestic machine tool industry (Investigation 332-149, announced on December 8, 1982). Any deferral of action on our Petition would, by permitting imports to continue at current levels and probably increase, result in further impairment of the national security.

II. DESCRIPTION OF THE MACHINE TOOL INDUSTRY

Machine tools are power-driven machines, not hand held, that are used to cut, form or shape metal. All machine tools can be broadly classified in either of the two principal families or sectors of machine tools: metal-cutting machine tools and metal-forming machine tools. These two sectors in turn encompass numerous types or categories of machine tools defined by their function and method of operation.

There are six basic categories of metal-cutting machine tools: drilling machines, milling machines, boring machines, turning machines (i.e., lathes), grinding and polishing machines, and sawing machines. Additionally, there are various types of special purpose metal-cutting machines that are based on these categories. Examples are machining centers, which combine drilling, milling and boring operations, and gear-cutting machines, which are special purpose milling machines. Another example, station-type machines, are machines that perform different metalworking operations at a succession of locations or "stations."

There are also six basic categories of metal-forming machine tools: punching machines, shearing machines, bending machines, forging machines, die-casting machines, and presses.

Metal-cutting machine tools. Among the metal-cutting machine tools, turning machines are distinct in that they operate by applying a stationary cutting edge to a rotating workpiece held in a chuck or similar device for the purpose of manufacturing a round product. Milling machines employ a rotating "cutter" to cut the surface of a stationary workpiece. Drilling and boring machines cut holes of various sizes in a workpiece. Grinding and polishing machines employ a grinding wheel to remove metal from a workpiece that may be either round or flat. Sawing machines saw metal to a desired design or cut a piece of metal from rough stock for further work.

Metal-forming machine tools. Metal-forming machine tools shape metal by applying force to it. Punching machines stamp designs out of sheet metal with the use of cutting dies. Shearing machines cut sheet metal with a blade that is applied to the metal with force. Bending machines bend sheet metal into cylinders, arcs and angles. Presses apply great force to bend, cut or punch metal. Forging machines compress pre-heated metal into a desired shape using dies. Die-casting machines inject molten metal into a die set to produce a complex shape by casting.

Uses of machine tools. Machine tools are capital goods used extensively in manufacturing articles comprised substantially of metal. For example, each automobile, locomotive, airplane, farm machine, appliance and most articles of military hardware require substantial machining on machine tools.

Machine tools also have an important, albeit indirect, role in the manufacture of numerous nonmetal products. For example, the pipes, valves and tubes required for chemical refineries are made on machine tools, as are the machines used to weave textiles and to process timber into lumber and other finished-wood products. In short, machine tools make numerous products including other machines and are the fundamental element of industrial production.

Size of the industry. The critical importance of machine tools for industrial production cannot be gauged by the size of the machine tool industry itself. The total production of machine tools in the United States during 1982 was $3.6 billion, which represented 0.12 percent of the gross national product. The last Census of Manufactures shows that in 1977 the machine tool industry was made up of 1,285 companies comprising 1,345 establishments, with industry employment then totaling 83,200.

Nearly two-thirds of the establishments had fewer than 20 employees. In both the metal-cutting and metal-forming sectors the 20 largest companies in the sector accounted for approximately 55 percent of sector shipments and the next 30 largest companies accounted for slightly over 20 percent of sector shipments. Only eight percent of the domestically-produced metal-cutting machine tools were built by companies other than primary manufacturers of metal-cutting machine tools. Similarly, only 13 percent of the domestically-produced metal-forming machine tools were built by such non-primary manufacturers. The industry is concentrated in the East-North-Central states.

Technological change. Like many other industries, the machine tool industry has been substantially affected by changes in technology and in manufacturing processes. These changes have implications for national security that are not, in the present state of affairs, reassuring. First, certain major customers of the machine tool industry have in recent years tended to order machine tools that are highly specialized in their uses and thus less easily adaptable to other uses. Such loss of flexibility harms our mobilization potential. Second, advances in technology have made it possible to produce sophisticated and more flexible machine tools (e.g., computer- or numerically-controlled ("CNC" or "NC") machining centers) that are required to make many products (such as modern weapons systems) involving new kinds of metals, tighter tolerances and greater complexity. In these circumstances, any foreign threat to the United States' technological leadership carries with it the risk that our national security will become dependent on foreign technology and sources of supply.

For many decades it was common for machine tool users to order, and for machine tool manufacturers to build, machines that were customized to serve the buyer's specific needs. Because only a few machine tools were produced in lots for sale from inventory, machine tool builders generally did not begin to manufacture a machine until an order for it was received. Consequently, the manufacture of many machine tools was a craft requiring highly skilled labor, and it was generally accepted that substantial lead times were required for the production of most machine tools.

To a significant extent, the production of machine tools in the United States today still exhibits many of these same characteristics. The desire for maximum efficiency in manufacturing processes has led some of the major customers of the machine tool industry, such as the automotive, off-road equipment and farm-implements industries, to order machine tools designed for an unusually high degree of specialization or, in industry parlance, machine tools "dedicated" to the production of a particular end product. While these "dedicated" machine tools are highly engineered and efficient, they are not easily adaptable to other uses. In contrast to the situation existing at the beginning of World War II, for example, the majority of the machine tools used by automobile manufacturers today to produce pistons could not, without major redesigning and rebuilding, be used to produce shell casings. In short, in the event of a national emergency it will not be as easy as it was at the beginning of World War II to convert many existing machine tools from the production of civilian goods to the production of military hardware. This obviously has serious implications for the nation's ability to mobilize rapidly.

At the same time, high technology is being applied to commercial machine tools with accelerating frequency and proven success. This trend is revolutionizing the performance capabilities of machine tools, and it is also revolutionizing the way in which machine tools themselves are made. A continuing decline in the cost difference between NC machine tools and conventional machine tools indicates both that NC machine tools will account for an increasing share of machine tool consumption in the United States and that a growing percentage of the machine tools consumed in the United States in the future will be produced in series or lots rather than individually. In an expanding number of circumstances, it is economically sensible for machine tool users to purchase multi-purpose NC machine tools, or clusters of such machine tools, that are customized not primarily by mechanical alterations to the machine tool itself but rather by specific computer-software packages (i.e., computer-aided manufacturing) or by the assembly of separate machine tool units into integrated manufacturing systems (so-called "flexible manufacturing systems").

Flexible manufacturing systems are not yet common in the United States and they also are not, despite their name, freely adaptable to a wide range of uses; their flexibility necessarily is limited by their software programs and by the considerable time and expense often required to write new programs. Nonetheless, the development of such increasingly sophisticated tools of production puts a premium on the domestic industry's ability to stay at the cutting edge of technological advances.

Changes in technology within the machine tool industry have, over the years, reduced the labor-capital ratio in the production of machine tools. This is illustrated in Figure 1.[1]

The overall level of skills required of the labor force, however, has not diminished. Highly-trained workers are still essential to produce the increasingly sophisticated and complex machine tools demanded by modern industry.

Figure 2 shows the increase in shipments of NC machine tools as a percentage of all machine tool shipments.

Cyclicality of demand. A longstanding characteristic of the machine tool industry that unfortunately shows no sign of changing is the extremely cyclical demand for machine tools. The level of orders for machine tools is determined primarily by industrial propensities to invest in capital goods; these propensities vary from sector to sector and from time to time. Financial and operating conditions, such as profitability, business confidence and the current and projected levels of capacity utilization, combine with changes in the economy-wide cost of capital and other factors to produce the complex lag relationship between demand on machine tool buyers and demand on machine tool builders. Fluctuations in demand and industry shipments have often been abrupt, as Figures 3, 4 and 5 show. Figure 5, showing the industry's shipments, includes the Department of Commerce's estimate of 1983 shipments. U.S. Department of Commerce, Bureau of Industrial Economics, 1983 U.S. Industrial Outlook for 250 Industries with Projections for 1987 (1983) (hereinafter 1983 Commerce Outlook).

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[1] Figure 1 is provided by Data Resources, Inc. ("DRI") based on an econometric model of the United States machine tool industry. This model ("DRI machine tool model") was developed by DRI for NMTBA.

DRI is a consulting and economic forecasting organization based in Lexington, Massachusetts. It is a subsidiary of McGraw-Hill, Inc.

The economic behavior of machine tool producers has been fundamentally affected by the cyclicality of their industry. Because of such cycles, the industry has tended not to invest in new capacity until the long-term need for such capacity becomes reasonably well established. To do otherwise would be to invest capital that would be unproductive during downturns in the industry's cycles and hence would produce, over the entire cycle, an inadequate return on investment. The industry has also sought to buffer its cycles by accumulating new orders during periods of strong demand and filling such orders during periods of slack demand. This policy minimizes layoffs of the skilled workers on which the industry depends and rationalizes production schedules. The result, however, has been that increases in new orders have been accompanied by lengthening lead times.

Among other results, the industry's cycles have: (1) made a high debt-equity ratio imprudent, if not impossible, in light of the attitude of lending institutions toward debt- service coverage during downturns in the business cycle, (2) required the industry to offset losses during bad years by achieving or attempting to achieve compensatory profits during good years, and (3) restricted the industry's ability to expand its production rapidly in response to increases in new orders.

The relatively small size of the companies comprising the United States machine tool industry and the constraints that its cyclicality imposes on their financing and operation have made this industry, and the enormous American market that it primarily serves, vulnerable to targeting by foreign governments. These governments have recognized, and have exploited, the competitive advantages that can be attained in this market by subsidized and governmentally-organized foreign companies.

Import penetration of the U.S. market. During the last ten years, the share of American consumption of machine tools supplied by foreign producers has risen dramatically from approximately 10.6 percent in 1972 to approximately 27.0 percent in the first nine months of 1982 when measured by value. Figure 6 summarizes the import trend since 1972.

It is ominous that imports have been successful in establishing a strong foothold in the high-technology sector of the machine tool market -- including especially the market for NC machines -- where the industry's most promising potential for growth lies. Of total consumption in the United States during the first three quarters of 1982, imports accounted for 51.2 percent of the value (72.0 percent of the units) of horizontal NC turning machines, 29.0 percent of the value (67.9 percent of the units) of vertical NC turning machines, 49.6 percent of the value (54.2 percent of the units) of non-NC turning machines, [illegible] percent of the value (78.9 percent of the units) of g[illegible]chines, 24.9 percent of the value (80.1 percent of the uni[illegible] machines, 28.8 percent of the value (49.9 percent of th[illegible] of forging machines, 38.8

percent of the value (64.4 percent of the units) of machining centers, and 48.4 percent of the value (24.7 percent of the units) of NC punching, shearing, bending and forming machines. The phenomenon of imports' penetration of the United States machine tool market is depicted in Figure 7.

III. IT IS A FUNDAMENTAL AND LONGSTANDING POLICY OF THE UNITED STATES THAT IMPORTS MUST NOT THREATEN TO IMPAIR THE NATIONAL SECURITY

The basis for our Petition is the National Security Clause of the United States trade laws, 19 U.S.C. § 1862, which serves as a nexus between the trade and national security policies of the United States. The Clause reflects the longstanding policy of Congress, that any advantages from international trade during peacetime must be subordinated to reasonable precautions for the national security. This policy, and the terms of the National Security Clause, are consistent with prevailing international law and are expressly acknowledged in Article XXI of the General Agreement on Tariffs and Trade ("GATT"). Indeed, it could hardly be otherwise, for no obligation of the federal government is more important than the protection of national security.

The National Security Clause's requirement that imports must not threaten to impair the national security is but one aspect of the more basic national policy to prepare in peacetime for the possibility of a future military conflict. In fact, this broader policy, as announced by the President, expressly provides for "increas[ing] the capability of industry . . . to meet national security needs through . . . use of import and export controls."[1]

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[1] National Security Decision Directive Number 47 (July 22, 1982) p. 6.

As the Secretary of Defense recently stated, support of "the national capacity to expand defense production rapidly during a crisis" is a task "to be undertaken with a high sense of urgency."[1]

Everyone hopes that the possibility of war of any kind with the Soviet Union and its allies is remote. But it cannot be denied that the possibility exists and that, in the face of that possibility, the government has -- as it has recently reaffirmed -- "[a] fundamental obligation . . . to provide for the security of the Nation . . . [by] hav[ing] an emergency mobilization preparedness program which will provide an effective capability to meet defense and essential civilian needs during national security emergencies."[2] It is national policy that such a preparedness program should "address the full spectrum of national security emergencies,"[3] including "a major military conflict."[4] In the same vein, the Secretary of Defense recently stated that "the United States must be prepared to cope with threats across the entire spectrum of conflict.[5]

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[1] Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, p. I-11 (emphasis added). See also, Annual Report of the Secretary of Defense to Congress, Fiscal Year 1984, p. 115 ("We also recognize the vital role that industry must play in developing a capability to surge industrial production . . . for only when American industry has the capability to modernize and expand production to meet increased demands for weapons systems and supplies during times of emergency can we confidently face today's rapidly changing world conditions").

[2] National Security Decision Directive Number 47 (July 22, 1982) at 1.

[3] Id. at 3.

[4] Id. at 5.

[5] Annual Report to Congress of the Secretary of Defense, Fiscal Year 1984, p. 37 (emphasis in original).

Specifically, one of the President's recent National Security Decision Directives provides for an emergency-mobilization-preparedness program to "increase the capability of industry . . . to meet national security needs . . . ."[1] The Joint Chiefs of Staff have observed that "[a]ny major confrontation with the Soviet Union would place extraordinary demands on war materiel critical to sustaining U.S. forces. A strong industrial base, capable of rapid expansion, is therefore critical to both deterrence and defense."[2] Consistent with this, congressional policy, as expressed in the Defense Production Act, is that "[i]n view of the present international situation and in order to provide for the national defense and national security, our mobilization effort . . . requires the development of preparedness programs and the expansion of productive capacity and supply beyond the levels needed to meet the civilian demand, in order to reduce the time required for full mobilization in the event of an attack on the United States or to respond to actions occurring outside of the United States . . . ."[3] This is not a new idea; for many decades it has been recognized that prompt mobilization of the Nation's industrial base is a prerequisite for meeting national emergencies successfully.

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[1] National Security Decision Directive Number 47 (July 22, 1982) at 6.

[2] Organization of the Joint Chiefs of Staff, United States Military Posture For FY 1983, p. 53.

[3] 50 App. U.S.C. § 2062 (Supp. V 1981).

Indeed, a review of the legislative history surrounding Congressional adoption of the National Security Clause impels one to the conclusion that the machine tool industry was precisely one of the industries Congress intended to protect through its enactment.

Prospects for improved deterrence and international security are equally important to an investigation under the National Security Clause. A strong industrial base that will support prompt mobilization and sustained fighting has substantial value as a tool for diplomacy and as a deterrent to war.[1]

Relations with allied and uncommitted nations may become strained [if there] is the perception on the part of a foreign government that the United States may be unable to meet its international defense commitments." With respect to unfriendly and aggressive countries, the Department of Defense has expressed particular concern with "how hostile nations perceive our resolve and ability to respond effectively to challenges."[2] Therefore, if the decisionmakers in the Executive Branch of the government are to maintain a prudent regard for the national security, as national policy requires, they must follow peacetime policies that assure the vitality of domestic industries that would be essential for a successful national mobilization.

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[1] Certainly Soviet military experts recognize the strategic importance of the strength of United States' industrial capability. See Sokolovskii, ed., Soviet Military Strategy, 3rd ed. (1968) trans. by Hariett F. Scott, pp. 108-109, 114; N. Ogarkov, "Na strazhe mirnogo truda" [On Guard for Peaceful Labor], Kommunist, No. 10, July 1981, pp. 82-83; K. V. Chicherin, "Mobilizatsiia" [Mobilization] Sovetskaia voennaia entsiklopediia [Sov. Military Encyclopedia], vol. 5, pp. 342-344 (1978); K.K. Belokonov, "Mobilizatsionnye vozmozhnosti gosudarstva" [Mobilization Potential of States], Sovetskaia voennaia entsiklopediia [Sov. Military Encyclopedia], vol. 5, pp. 340-341.

[2] Submission of the Department of Defense of February 26, 1979, supra.

The National Security Clause is not only a fundamental part of the United States law and policy. It also reflects the prevailing law among nations. The relevant international law is found in Article XXI of the General Agreement on Tariffs and Trade, which provides that:

> "[n]othing in this Agreement shall be construed . . . (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests. . . (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment. . . ." (Emphasis added.)

As Professor Jackson has observed, this "language explicitly gives the right of determining necessity to each individual government."[1] Moreover, "[d]uring the discussion in the GATT session, it was stated that 'every country must have the last resort on questions relating to its own security.'"[2]

The Friendship, Commerce and Navigation Treaties between the United States and most of its major trading partners, including Japan and the Federal Republic of Germany, contain similar provisions[3].

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[1] J. Jackson, World Trade and the Law of GATT § 28.4 at 748.

[2] Id. at 749, quoting GATT Doc. CP.3/SR.22, at 7 (1949).

[3] 4 U.S.T. 2063, 2078-79, T.I.A.S. No. 2863, Aug. 29, 1953 (United States-Japan); 7 U.S.T. 1839, 1863-64, T.I.A.S. No. 3593 (United States-Fed. Rep. of Germany).

These articles of GATT and the FCN Treaties were in existence when Congress enacted the National Security Clause. It can be assumed, therefore, that Congress concluded that the National Security Clause is consistent with their terms.

Moreover, the terms of the Clause are consistent with conventional politico-economic theory. Economists traditionally justify free trade as "a more efficient employment of the productive forces of the world."[1] The theory of comparative advantage, which underlies much of international economics, suggests that trade enhances the potential for world production by allowing countries to specialize in the production of certain items as to which they enjoy advantages and to give up production of items as to which they suffer disadvantages.[2] However, economists readily recognize that this model of international economic interdependence cannot apply to the extent that actual or potential political hostilities threaten to deny certain nations' access to the goods produced in other nations. In other words,

> "economic welfare is not the sole goal of life. Political considerations are also important. Thus, it may be necessary to become partially self-sufficient in certain lines of activity, even at great cost, because of fear of future wars."[3]

In the absence of government subsidies or outright nationalizations, tariffs or quotas may be necessary to protect industries vital to national security. Although it is often argued that protectionism may reduce the wealth of nations, the failure to protect national security may be even more devastating. In the end, of course, marginal changes in national income are not the decisive factor. As Adam Smith observed in his discussion of commercial trade, "Defense is of much more importance than opulence."[1]

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[1] J.S. Mill, quoted in P.A. Samuelson, Economics 626 (11th ed. 1980).

[2] R.E. Caves and R.W. Jones, World Trade and Payments 25-31 (1973); C.P. Kindleberger, International Economics 19-37 (4th ed. 1968); P.A. Samuelson, Economics 626-49, 656 (11th ed. 1980).

[3] P.A. Samuelson, *supra*, at 652.

IV. THE READY AVAILABILITY OF MACHINE TOOLS IS CRITICALLY IMPORTANT TO THE NATIONAL SECURITY

"Our Nation's security rests in large measure on machine tools."[2] A sufficient number of the right kind of machine tools is the critical prerequisite to industrial support for the military during a national security emergency. In other words, "machine tools . . . are the seed corn of armament as well as all other production."[3]

Without machine tools, industry cannot begin to produce the vastly increased quantities of military equipment that mobilization requires. Every ship, plane, tank, missile, transport vehicle and other armament used by our armed forces, as well as essential elements of the supporting civilian infrastructure, are manufactured in large part on machine tools. Moreover, the production of sophisticated modern weapons increasingly requires high-technology machine tools, because the computer controls on such tools can assure the precise tolerances necessary for successful operation of the finished product. Ever since World War I Congress, the Executive and the armed forces have recognized the critical importance of machine tools to the national security. Only recently, the government reemphasized this importance when reinstituting a "Trigger Order Program" for the more rapid procurement of American-made machine tools in times of national emergency.[1]

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[1] A. Smith, quoted in C.P. Kindleberger, at 116.

[2] Defense Production Act, Progress Report No. 13, Machine Tools, U.S. Congress, Joint Comm. on Defense Production, S. Rep. No. 1107, 82 Cong. 2d Sess. 1 (1952) (hereinafter Joint Committee on Defense Production Report No. 13). The introductory sections of the Report are reprinted in Appendix H.

[3] "The Machine Tool Fumble," Fortune, p. 56 (Jan. 1952).

A. Machine Tools Have Long Been Recognized as Essential to Military Production.

The Defense Acquisition Regulation[2] ("DAR") specifically recognizes that most types of machine tools and related products are considered "indispensable for national security or national defense purposes." Part 16 of Section VI of the DAR, promulgated on January 7, 1981, by the DAR Council, permits the Department of Defense, pursuant to the Trade Agreements Act of 1979,[3] to purchase goods made in certain foreign countries without regard to the restrictions of the Buy American Act or DOD's Balance of Payments Program (§ 6-1601(a) and (b)), except in the case of

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[1] FEMA Forum, September 1982.

[2] 32 C.F.R. Parts 1 to 39 (1982). This regulation, issued by the Department of Defense under the authority of the Armed Services Procurement Act and the Defense Production Act, was formerly known as the Armed Services Procurement Regulation.

[3] Public Law 96-39, 19 U.S.C. 2501 et seq. (Supp. V 1981).

"purchases indispensable for national security or national defense purposes" (§ 6-1603(iv)). The regulation then lists fifty-eight categories of products that are generally not indispensible, and expressly excludes from this list twenty-one categories of machine tools and related products which, because of their use in the production of weapons, are deemed by DOD in applying the DAR to be "indispensible for national security" (§ 6-1607).[1]

In addition, government policy recognizes that certain high-technology machine tools are so essential for the production of state-of-the-art weapons that it has forbidden their export to

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[1] These categories are as follows (CCH Government Contracts Reports ¶ 37,620.18 (1983)):

Federal Supply Class Number	Supply Class Title
3408	Machining Centers and Way-Type Machines
3410	Electrical and Ultrasonic Erosion Machines
3411	Boring Machines
3412	Broaching Machines
3413	Drilling and Tapping Machines
3414	Gear Cutting and Finishing Machines
3415	Grinding Machines
3416	Lathes
3417	Milling Machines
3418	Planers and Shapers
3419	Miscellaneous Machine Tools
3426	Metal Finishing Equipment
3433	Gas Welding, Heat Cutting and Metalizing Equipment
3441	Bending and Forming Machines
3442	Hydraulic and Pneumatic Presses, Power Driven
3443	Mechanical Presses, Power Drive
3446	Forging Machinery and Hammers
3448	Riveting Machines
3449	Miscellaneous Secondary Metal Forming and Cutting Machines
3460	Machine Tool Accessories
3461	Accessories for Secondary Metalworking Machinery

adversaries of the United States.[1] Virtually all machine tools are important for the manufacture of weapons and other items used by the armed forces; the machine tools that are subject to export restrictions, however, incorporate technology that would permit the Soviet Union and its allies to construct weapons that are presently beyond their grasp.[2]

The importance of machine tools for military production, clearly recognized in the many statements and government programs discussed above, is underscored by data showing the large portion of aggregate machine tool consumption that is linked directly or indirectly to defense. Machine tool production for defense falls into three categories. The first two categories are the direct and indirect purchases of machine tools by the Department of Defense.[3] The third category, referred to as "induced capital" purchases, consists of purchases by defense contractors, subcontractors and suppliers for use in the production of ships, airplanes, tanks and all other weapons and military equipment. Figure 8[1] shows the portions of domestic consumption of machine tools over the last six years attributable to direct and indirect defense purchases and defense-contractor purchases.

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[1] See 15 C.F.R. Part 399 (1982), based on the Export Administration Act of 1979, Pub. L. No. 96-72, 93 Stat. 503.

[2] Thus, the Secretary of Defense has warned that the export of "precision machine tools" to the Soviets may jeopardize the national security by allowing them "to improv[e] their industrial base." Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, p. II-31. See generally Freedenberg, "U.S. Export Controls: Issues for High Technology Industries," National Journal 2190, 2191 (December 18, 1982) ("There is essential agreement that certain categories of high technology items should not be sold to the Soviets or their Communist allies").

[3] Direct purchases by the Department of Defense include purchases of machine tools for government arsenals, shipyards and other defense agencies. Indirect purchases include purchases by private parties on current account (e.g., purchases of machine tools by private shipbuilders for installation in machine shops on shipboard) for delivery to defense agencies.

The "induced capital" consumption of machine tools shown in Figure 8 includes defense-related machine tool purchases on capital account by prime defense contractors and by the machine tool industry itself. However, it does not include defense subcontractor purchases of machine tools or other tertiary purchases of machine tools related to defense. The Department of Commerce has "estimated that about half the [defense] prime-contract awards are passed along to subcontractors." Henry, "Defense Spending: A Growth Market for Industry," 1983 Commerce Outlook, supra, at XL (emphasis added). For example: "Subcontractors produce jet engine blades, landing gears, avionics, ball bearings and castings used in aircraft, tanks, and ships. These subcontractors are in turn supported by component and parts suppliers down to and through the basic metals industries." Id. Thus the true induced-capital defense-related demand for machine tools is likely more than double the amounts specified in Figure 8.

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[1] Data for Figure 8 were determined by Data Resources, Inc., based on the DEIMS and DIFS modeling systems. The mechanism for "translating" categories of defense expenditures into demands on private industry is based on the Department of Defense procedures.

The analysis demonstrates that, by conservative estimate, up to 20 percent of the aggregate domestic consumption of machine tools is related to defense needs even in peacetime.

The remaining portion of the domestic consumption of machine tools is of course related to civilian needs. Although some portion of the machine tool industry's production for civilian needs could be diverted to defense-related needs in a time of mobilization, a substantial portion could not be so diverted without seriously damaging the civilian economy including the essential civilian infrastructure (transportation and communications systems, etc.) that has to operate efficiently if defense production and the war effort itself are to be successful. DRI, in estimating machine tool supply and demand in wartime for purposes of the Petition, has assumed that civilian discretionary expenditures would be reduced to austere levels as a result of a sharp increase in the personal savings rate, thus freeing substantial capital-goods production capacity for defense purposes.

B. Considerations of Deterrence and Promptness of Military Response Require a Production Capacity Adequate to Satisfy an Immediate and Sharp Increase in the Demand for Machine Tools

Because machine tools are required to make so much of what the military requires, a demand for machine tools far greater than peacetime demand arises immediately when a serious national security emergency erupts and continues for a substantial period thereafter. For this reason, both the nation's strategy of deterrence and its ability to respond promptly to an actual emergency are critically dependent on domestic machine tool production capacity.

The armed forces have long recognized that their war effort would be severely prejudiced if, as a result of inadequate machine tool production capacity, military production were delayed until machine tool factories were built or expanded. Machine tools are necessary for expanded defense production, and "our capacity for expanding defense production is of very great strategic importance. This capacity helps to deter precisely the aggressive moves that might lead to such an expansion, and it plays a critical role in our policy for a conventional war."[1]

Mobilization of the United States for World War I, World War II and the Korean War required levels of machine tool production many times higher than the production that had been required to supply civilian demands before hostilities began.

To a significant extent this surge in production was made possible by converting to the production of new machine tools many existing machine tools that had been used before the war for the production of civilian goods -- a conversion that may not be possible, at least to the same extent, today.[2]

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[1] Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, p. I-14.

[2] See generally J.S. Gansler, The Defense Industry 109-10 (1980):

> "The many people who still think the United States could quickly resume the rate of industrial military production that was present at the end of World War II neglect the increased complexity of today's military equipment. The production process is more difficult, the skill levels required are higher, the material lead times longer, the part tolerances much tighter, and the designs far more complex. They also neglect the long buildup time allowed by America's physical isolation from that war's beginnings in Europe. Thus, a critical question in the area of strategic industrial responsiveness is the likely intensity and duration of a future military conflict."

In a future national emergency the machine tool industry would once again be called on to respond vigorously at the outset of the emergency and to sustain vigorous performance for its duration. Recently, for example, the Federal Emergency Management Agency recognized "the vast increase in demand for metal cutting machine tools [that occurs] during mobilization periods."[1]

Moreover, a future national emergency is likely to present mobilization problems considerably more difficult than those presented in the case of the world wars -- problems that underscore the need to keep the United States machine tool industry in a state of readiness during peacetime.

C. It Must Be Assumed That The United States Would Need Massive Quantities of Machine Tools During a National Security Emergency in the Future.

Protection of the national security requires preparation for a protracted conventional war with the Soviet Union. The popular image of war with the Soviets -- "a single, very quick spasm exchange [of nuclear bombs] after which all is devastation and silence"[2] -- remains a possibility but a decreasing one. There is a significantly greater possibility today, in contrast to ten years ago, that a war with the Soviet Union, if it occurs, would be a conventional war of long duration rather than a conflict terminated at an early date by escalation to nuclear weapons. The key Department of Defense planning document, "Fiscal 1984-1988 Defense

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[1] FEMA Forum, Sept. 1982, p. 1.

[2] Seymour Weiss, "Why We Must Think About Protracted Nuclear War," The Wall Street Journal, Aug. 30, 1982, p. 12.

Guidance," has been reported as requiring that U.S. conventional forces should be able to fight Soviet forces on several fronts for an "indefinite period."[1] Moreover, "[e]very administration and every secretary of defense" since the Kennedy Administration has realized "that relying solely on a strategy of massive nuclear retaliation [is] not a credible deterrent to the wide range of nuclear and conventional attacks which the Soviets [have] develop[ed] the capability to conduct."[2] Thus an adequate deterrent posture requires the ability to fight a conventional war.

Many Western experts on the Soviet Union believe that although the Soviet leaders have prepared for a protracted conflict, they have compelling reasons for wishing to avoid one.[3] In the circumstances, the United States' deterrence posture will be particularly effective if, and only if, the United States is perceived by the Soviets as having the capacity both to deny them a quick victory and to wage a protracted war.[1]

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[1] "U.S. arms plans bared," The Chicago Tribune, Jan. 17, 1983, p. 1.

[2] Letter, Caspar W. Weinberger, Secretary of Defense, The Washington Post, Nov. 9, 1982. p. A21.

[3] "Soviet military doctrine holds that if war breaks out in Europe, it must be won very quickly by the Soviet Union if it is to be won at all. If the war drags on, there is a high risk either that it will develop into a catastrohic strategic nuclear exchange or that the strains of war will destroy the Soviet Bloc from the inside. Either way, the social system established by the Communist Party would probably perish, and the present leadership would be killed. The Soviet leadership understandably would be unwilling to pay this price. It is probably unlikely, therefore, that the Soviet leaders would choose to start a war in Europe (or elsewhere) unless they were confident of a quick and complete victory." C.N. Donelly, "The Soviet Operational Manoeuvre Group: a new challenge for NATO", 15 International Defense Review, No. 9 pp. 1177-78 (1982).

It is of course impossible to know whether a war with the Soviet Union and its Warsaw Pact allies will occur and, if it does occur, the form it will take. Certainty, however, is not required, or even expected, in the defense-planning process. It is sufficient that the government has recognized that there is a substantial possibility of a protracted, perhaps multi-theater, conventional war with the Soviets and has declared that it is national policy to prepare to meet that possibility. There can be no doubt that, if such a war took place, a vast number of machine tools would be required to fight it.

To estimate the quantity of machine tools that would be needed during future national-security emergencies, Data Resources, Inc. ("DRI") has developed an economic model that projects the demands for metal-cutting and metal-forming machine tools under alternative military-defense scenarios. We will discuss these scenarios and their impacts on machine tool demand later in our testimony.

V. THE PRESENT QUANTITY AND CIRCUMSTANCES OF IMPORTS OF MACHINE TOOLS THREATEN, AND WILL CONTINUE TO THREATEN, TO IMPAIR THE NATIONAL SECURITY

The recent, rampant growth in the share that imports hold in the United States machine tool market has set in motion a trend toward the debilitation of the United States machine tool industry; that in a time of serious national emergency, the United States could not count on foreign suppliers of machine tools; and that the government's only programs for assuring the availability of machine tools in a national emergency -- the Machine Tool Stockpile and the Trigger Order Program -- are clearly insufficient for that purpose.

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[1] "Any U.S. strategic retaliation must be controlled by and responsive to the [National Command Authority], tailored to the nature of the Soviet attack, focused on Soviet values, and inevitably effective." Organization of the Joint Chiefs of Staff, United States Military Posture For FY 1983, p. 19.

If, the trend toward debilitation is permitted to continue, substantial existing machine tool manufacturing capacity will be effectively displaced from the United States to overseas locations that may not be accessible to us during a serious national security emergency. Equally threatening to the national security is the damage to the financial and competitive strength of the remaining portion of the United States machine tool industry, with the resulting damage to its ability to innovate and maintain its technological stature, that would occur if this trend continues. In short, current trends, if they continue unchanged, will almost certainly leave the United States with a machine tool industry that is smaller and weaker than can be prudently tolerated -- an industry that is permanently debilitated and inferior. Such a development would be a serious impairment of the nation's national security.

A. The relevant economic data show a depressed domestic machine tool industry.

The United States machine tool industry is severely depressed. Current data on orders, shipments, employment, profits, capital formation and capacity utilization all point to the conclusion that the industry is experiencing unprecedented strains -- strains that cannot safely be assumed to be a result of the business cycle.

1. New orders. The leading indicator of the health of the machine tool industry is "net new orders," defined as aggregate new orders minus cancellations of outstanding orders. Machine tool orders are placed primarily by the metalworking industries during times when firms anticipate plant expansions or the replacement or upgrading of existing capital equipment. They form the basis for machine tool builders' plant utilizations, financial planning, capital outlays and manpower deployment.

Figure 9 shows the precipitous drop in the last four years in net new orders for machine tools. From the first quarter of 1979 through the fourth quarter of 1982, the constant-dollar value of net new orders plummeted by over 84 percent, reaching a level of $105 million as of the fourth quarter of 1982. The plummeting of the net new-order figures reflects the simultaneous occurrence of a dramatic reduction in the number of new orders placed and a sizeable increase in the cancellation rate on outstanding orders. To put this decline in perspective, net new orders for 1982 on a constant-dollar basis amounted to approximately half the value of orders placed in 1975, when the industry was at the bottom of its preceding business cycle.

2. Shipments. Similarly, as shown in Figure 10, the constant-dollar value (1972 dollars) of machine tool shipments has declined over the past three years from a peak of $503.5 millions in the fourth quarter of 1979 to a level of $266.8 million in the third quarter of 1982, the latest quarter for which data are available. This represents an aggregate decline of 47 percent.

The decline in value of shipments is less than the decline in value of net new orders during the same period only because the industry has been building and shipping machine tools to fill accumulated orders. As these outstanding orders have been filled, however, the industry's backlogs have been reduced, as Figure 11 shows, and future shipments will necessarily fall to a level corresponding to the low level of new orders. Conversely, when there is an upturn in net new orders, there will be a lag of several months before there will be a corresponding upturn in shipments.

The collapse in demand for domestic machine tools has had predictable adverse effects on the industry' health: among other things, employment has fallen dramatically and capital spending plans have been deferred or cancelled. Equally ominous for the future, the industry' profits, sustained until recently by shipments in fulfillment of outstanding orders, have now fallen or are projected to fall to the point that United States government financial analysts give the industry the lowest ranking of 212 industry groups for 1983 and private securities analysts are advising their clients to avoid investing in the industry. These adverse effects are discussed below.

3. Employment. Employment statistics are another indicator of the severity of the downturn in the machine tool industry. Figure 12 shows total industry employment annually for the years 1972 through 1979 and monthly for the years 1980 through 1982. In December 1975, at the bottom of the last recession, the total employment in the industry was 82,800. Five years later, at the peak of the next cycle in April of 1980, the industry's employment had grown to 110,200. Since then, however, employment has fallen sharply to 68,600 as of December 1982, the latest month for which figures are available. This represents a 37.7 percent decline in employment -- a

loss of more than 41,000 jobs -- in less than two and one-half years. Total employment thus stands at a level substantially below the level that was reached at the bottom of the last cycle.

Figure 13 breaks out separately the industry's total employment of "production workers" annually for the years 1972 through 1979 and monthly for the years 1980 through 1982.

This category, which excludes employees engaged in sales, service and administrative occupations, includes the skilled machinists and other production employees whose training and experience are essential to any mobilization effort. Employment of those workers has fallen 46.2 percent from a peak of 73,700 in April of 1980 to 39,600 as of December 1982.

The decline in employment of production workers is proportionately greater then the decline in overall employment and has reached into the ranks of workers with relatively high levels of seniority and competence. Industry management is deeply concerned about the implications of this development for the industry's competitive position. The quality of the industry's products depends to a substantial extent on the competence of its production workers. Skilled production workers who are laid off and then find other jobs will be reluctant to return to a cyclical industry that is seriously threatened by imports. The training of replacement workers typically takes two to four years. In the meantime, production efficiency and product quality are likely to suffer, thereby further eroding the industry's competitive position.

Nor does the foregoing employment data fully reflect the depressed state of the domestic machine tool industry. Many workers who remain on the payroll are working short weeks; seven-hour days and four-day weeks, for example, are common.

There is no doubt that imports of machine tools have had a detrimental impact on American workers in the machine tool industry. The Employment and Training Administration, Office of Trade Adjustment Assistance, Department of Labor, has reported that since 1980 more than 30 petitions for workers adjustment assistance have been filed by the machine tool industry. These petitions cover more than 2,200 employees of machine tool establishments. Worker adjustment assistance is authorized by the Trade Act of 1974 upon a finding by the Secretary of Labor "that increases of imports . . . were a substantial cause of [the] total or partial separation . . . [of] a significant number . . . of the workers in [a firm]." As of December 31, 1982, petitions covering 953 machine tool employees had been certified, and an additional 45 percent of the petitions were still pending.

4. Capacity utilization. The operating rate of capacity utilization rate measures "[t]he ratio of physical output to physical capacity."[1] Figure 14 records the operating rate for the nonelectrical machinery industry annually for the period 1972 through 1979 and monthly for the years 1980 through 1982 as reported in the long-standing McGraw-Hill surveys.[2]

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[1] The McGraw-Hill Dictionary of Modern Economics (2d ed. D. Greenwald 1973), p. 412.

[2] McGraw-Hill Publishing Company, Department of Economics, "McGraw-Hill Operating Rates Report" (monthly).

As Figure 14 shows, capacity utilization as of December 1982 was 62.2 percent, its lowest point in the history of index.[1] Understandably, numerous plants have been or are being closed, resulting in a permanent loss of production capacity. In the Cleveland area, for example, among major machine tool builders both Acme-Cleveland Corporation and Warner & Swasey Company (a subsidiary of Allied/Bendix) have recently closed plants and offered them for sale. Among other publicly-held companies, Ex-Cell-O Corporation and Cross & Trecker Corporation, both based in Detroit, have recently announced plant closings.

The nonelectrical machinery industry encompassed by the McGraw-Hill report is broader than the machine tool industry, but its operating rates are considered to be fairly representative of those experienced by the machine tool industry over a full business cycle. The McGraw-Hill definition of production capacity appears to fall somewhere between the economic definition of capacity as the "efficient" or "minimum cost" level of production and the engineering definition of capacity as the maximum or "physical limit" of production obtainable regardless of costs. As alternatives to the McGraw-Hill survey, DRI has developed capacity utilization measures specifically for the machine tool industry using separately the economist's and the engineer's definitions of capacity.

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[1] In January 1983 the McGraw-Hill index dropped to a new all-time low of 62.1 percent.

Figure 15 shows the nonelectrical machinery industry's history of capacity utilization as reported in the McGraw-Hill survey (the same as Figure 14) and, for the same years, the machine tool industry's history of capacity utilization as determined by DRI based on two alternative measures of capacity.

Predictably, DRI's two indexes show rates of capacity utilization respectively above and below the rates reported by the McGraw-Hill index. By all three measures, however, it is clear that capacity utilization in the machine tool industry has declined sharply since 1979.

5. Industry profits. Figure 16 shows the industry's pre-tax profits as a percentage of sales for the years 1972 through 1982.

Figure 17 shows for the years 1972 through 1982 the industry's pre-tax profits expressed as a return on gross assets. Figures 16 and 17 document the fluctuations in the industry's profits and the sharp drop in those profits in 1982. The profit outlook for 1983 is even worse.

The risks of investing in the machine tool business are reflected by the uncertainty of the industry's earnings performance over the years. Even under normal conditions, earnings fluctuations in this industry are greater than those experienced by manufacturing industries generally. With imports now holding a large and increasing share of the market, the risks of investing in the machine tool industry are accentuated. Unless the projected returns on investment are high enough to compensate for those risks, managers cannot justify decisions to reinvest conglomerate parent corporations engaged in other lines of business, will invest their capital elsewhere.

6. Capital investment. Not surprisingly, in view of the substantial decline in new orders, shipments and profits, the industry's constant dollar net capital investment fell off perceptible in 1982. As shown in Figures 18 and 19, the industry's net new investment in 1982 was inadequate even to cover the depreciation of existing plant and equipment, resulting in a decline in net plant and equipment on hand. This may be contrasted with what probably would have been the industry's investment performance in the absence of imports.

7. Research and development. Figure 20 shows the industry's aggregate expenditures for research and development for the years 1972 through 1981.

Figure 20 shows that the industry has held fairly steady through 1981 in its research and development expenditures. In the circumstances now facing the industry, however, it is far from clear that this will continue. Any significant decline in -- indeed, any failure to increase -- R&D expenditures would have ominous implications.

Given the rapid advances in technology that are affecting the industry and its customers, expenditures for research and development are the lifeblood of the machine tool business. To compete effectively in the domestic and export markets, the industry must retain the ability and the incentive to continue and increase its R&D expenditures. If the industry's sales and profits continue to decline, however, this will become impossible. The result will be a vicious circle in which declines in sales and profits will retard technological advances, causing further declines in sales and profits, with the cycle continuing until the industry has fallen irretrivable behind in foreign competitors. The risk that the domestic machine tool industry may thus be eclipsed by its foreign competition -- as other once-strong United States industries already have been -- has obvious importance for the national security.

8. Industry outlook. As mentioned above, the Department of Commerce has ranked the machine tool industry dead last among 212 industry groups in its forecast of product shipments for 1983. According to the Department of Commerce, the constant-dollar value of shipments in 1983 of metal-cutting machine tools made by United States manufacturers is expected to decline to $950 million, which is 34.3 percent below the already severely depressed level of 1982;[1] similarly, shipments of metal-forming machine tools are expected to decline to $260 million, which is 30.1 percent below the 1982 level.[2] The Commerce Department expects these declines to result in further layoffs in 1983 of 10.3 percent in the metal-cutting production workforce and 6.2 percent in the metal-forming production workforce.[3]

Among private analysts, Eli S. Lustgarten, a respected investment advisor and observer of the machine tool industry, has stated that "[i]t is unlikely [that] the machine tool industry will be profitable in 1983."[1] He comments:

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[1] Id. at 20-2 (shipments are expressed in 1972 dollars).

[2] Id. at 20-3.

[3] Id. at 20-2, 20-3.

> "New orders over the past three years have plummeted nearly 75%. . . . Declining new orders and a sharp increase in the cancellation rate . . . has resulted in a 75% decline in the industry backlog. . . . [With the industry able to] produce in excess of $5 billion of equipment (in 1981 dollars) . . . capacity utilization is likely to fall to 35-45% or less over the next 12 months as shipments fall [by approximately one-third] in 1983. . . . Imports continue to gain share of U.S. machine tool consumption.
>
> "The bottom line is that machine tool manufacturers will lose money over the next 12 months with plant closings, layoffs and severe price discounting."[2]

Lustgarten warns investors, "avoid this sector in general."[3] Similar advice has been issued by The Value Line Investment Survey.[4]

Notwithstanding the apparent end of the recent recession, the outlook for the machine tool industry bears out these gloomy projections. In 1982, overall business expenditures by manufacturers in the United States on new plant and equipment, such as machine tools, declined 6.9 percent below the real level of such expenditures in 1981.[5] Such expenditures declined by 8.2 percent in the case of manufacturers of durable goods -- which include many purchasers of machine tools -- and by 5.6 percent in the case of manufacturers of nondurable goods.[1] Significantly, United States manufacturers as a whole are still operating at just slightly more than two-thirds of capacity,[2] and "[t]raditionally, the upturn for machine tools comes when capacity use [in manufacturing industries] hits 80% . . . ."[3] As a result, real fixed investments by United States manufacturers are expected to fall another 5 percent during 1983.[4] The only leading economic indicator announced on March 2, 1983, that continued to fall was "the level of contracts and orders for business plant and equipment."[5]

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[1] Paine Webber Mitchell Hutchins Inc. (Eli S. Lustgarten), "Machine Tool Industry: Is There Life After Detroit?" December 6, 1982, p. 1.

[2] Id. at 1-2.

[3] Id. at 1.

[4] The Value Line Investment Survey, pp. 1342-52 (February 25, 1983). Cross & Trecker, for example, has already disclosed that it anticipates that its sales in 1983 will decline to 50 percent of its depressed sales in 1982. See "Industrial equipment and services," Forbes, Jan. 3, 1983, p. 130.

[5] "Plant and Equipment Expenditures, Quarters of 1982 and First and Second Quarters of 1983," 62 Survey of Current Business 32 (December 1982).

Even if the hoped-for decrease in world oil prices materializes and the promising economic news of the last two months matures into a strong and sustained national economic recovery, it is unrealistic to assume that the growth of the United States economy in 1983 will, by itself, bring new life to the machine tool industry. For the reasons stated earlier, the recovery of a capital goods industry like machine tools lags months behind a strong upturn from a recession. And, ironically, a strong economic recovery among the manufacturing industries that are the primary purchasers of machine tools may not benefit the United States machine tool industry in 1983. This follows from the enormous inventories of imported machine tools presently sitting in United States warehouses.

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[1] Id.

[2] Federal Reserve Statistical Release G.3(402) (December 1982).

[3] "Industrial Equipment and Services," Forbes, p. 130 (Jan. 3, 1983).

[4] "Plant and Equipment Expenditures, Quarters of 1982 and First and Second Quarters of 1983," supra, at 33.

[5] Washington Post A12 (March 3, 1983) (citing U.S. Department of Commerce, Composite Indexes of Leading, Coincident and Lagging Indicators).

If, in response to a buoyant economy, machine tool purchasers seek immediate delivery, they will obviously prefer imports that can be delivered from stock. United States machine tool builders, by contrast, are financially unable, for the most part, to manufacture and carry substantial machine tool inventories. In short, there is a real danger that imports may enjoy the lion's share of the economic recovery, at least in the short term, and in the process expand their share of the United States market even further.

Moreover, in 1983 the United States machine tool industry cannot expect to compensate for the anticipated serious decline in domestic sales by expanding its exports to foreign markets. In 1982 the export market for United States machine tools weakened considerably due to world-wide economic stagnation and a strong U.S. dollar. Exports of approximately $615 million in 1982 were off by 40 percent in comparison with 1981, a decline even greater than the decline in the industry's overall shipments. Most forecasters project little or no growth in the economies of the industrialized Western nations during 1983. Consistent with this, the Department of Commerce estimates that exports of United States machine tools will decline by more than 30 percent in 1983.

B. Imports Threaten Further to Debilitate the United States Machine Tool Industry and to Shift the Facilities for Production of Machine Tools Required by the United States to East Asia and Western Europe.

While precipitate declines in demand are not new to the machine tool industry, the recent explosion in imports' share of the United States machine tool market makes the present, extremely deep trough in the industry's cycle far more threatening to the industry's viability than any previous trough, for the reasons that follow.

1. Current import trends will result in a critically weakened industry.

Ten years ago imports accounted for approximately 11.0 percent of the metal-cutting machine tool market and 9.0 percent of the metal-forming machine tool market in the United States.[1] The United States enjoyed a positive balance of payments with respect to machine tools as a result of the domestic industry's export of $350.5 million worth of tools to foreign customers compared with imports of $167.1 million.[2] By 1982 these statistics had changed radically. *See* Figures 21 and 22.

By October of 1982, imports had grown to 27.8 percent of the metal-cutting market and 22.9 percent of the metal-forming market in the United States, and for the full year 1982 the United States had a hefty deficit of $638.3 million in international machine tool trade. As Figure 21 shows, since 1977 imports' share of the United States market has grown an average of more than two percentage points per year from 16.5 percent to 27.0 percent, a 64 percent increase in market share. Figure 22 shows the shift in the United States' trade balance in machine tools from a surplus up to 1977 to a deficit thereafter. The primary source of import growth is Japan, whose share of the total United States machine tool market for the first nine months of 1982 was 12.3 percent and whose share of the imports sold in the United States market amounted to over 44 percent.[1] Other significant foreign sources of supply include West Germany, the United Kingdom, Taiwan and Switzerland, as shown in Figure 23.

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[1] NMTBA, Economic Handbook of the Machine Tool Industry, 1982-83, Chapters 4 and 5.

[2] *Id.*, pp. 128 and 13

In the absence of the relief requested in our Petition, imports will continue to capture an increasing share of the United States machine tool market. The Commerce Department's forecast for 1983 shows a market share increase of 6.9 percentage points for imports of machine tools. For purposes of our petition, DRI has projected a more conservative two prcentage point growth in import market share.

The foregoing statistics show the recent explosion of imports in the United States market. As alarming as they are, however, these statistics significantly understate the extent of the threat to the United States machine tool industry. As mentioned earlier, the machine tool industry today is being revolutionized by the marriage of high technology, especially computers, with the mechanical elements of conventional machine tools. Such numerically-controlled or computerized ("NC" or "CNC") machine tools are the principal growth sectors of the industry. As they continue to decrease in cost relative to conventional machine tools, demand for NC and CNC machine tools will continue to supplant the demand for conventional machine tools.

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[1] The Japanese share of the world export market for machine tools was 13.4 percent in 1982. American Machinist Magazine (February 1983). Thus the Japanese share of exports to the United States was more than three times greater than its world average.

Although NC machine tools were for the most part developed and introduced to world markets by United States builders, foreign builders have been able to reap a substantial share of the profits. Largely as a result of reverse-engineering and governmental support in the form of aggressive targeting programs, the Japanese alone "have seized a third of the growth segment of the [United States] machine-tool market -- sophisticated, numerically controlled lathes and machining centers."[1] For the full year 1982, Japan supplied 80.6 percent of all NC turning machines and 89.0 percent of all machining centers imported into the United States.[2]

As in the case of many other products, the manufacture of high technology machine tools involves an important "experience curve" phenomenon. As production increases, the experience curve -- reflecting, among other things, cost reductions and quality improvements -- rises sharply.[3] If foreign manufacturers of "high technology" machine tools are able to increase their cumulative production experience by dominating the United States market during the next several, critical years, the result may be an unchallengeable lead in cost reduction and new product development.

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[1] "The Vise Tightens on Toolmakers," Business Week, Dec. 6, 1982, p. 63.

[2] See Department of Commerce, Import Report IM146 (monthly).

[3] E.g., I. Magaziner and R. Reich, Minding America's Business, The Decline and Rise of the American Economy 89-90 (1982); Paine Webber Mitchell Hutchins Inc., "Machine Tool Industry: Is There Life After Detroit?" 4 (December 6, 1982).

2. The domestic industry has been disadvantaged by international trade practices.

Imports appear to have a secure hold on the major share of the United States market that they have recently captured. Indeed, their share of the United States market is continuing to grow even when lead times of domestic producers have dropped and capacity has become available. The threat that imports pose to the domestic industry is especially ominous because the substantial competitive advantages that imports enjoy are attributable in large part to direct governmental subsidization or the effects of governmental coordination of machine tool producers.

The Government of Japan has been particularly aggressive in its protection, subsidization and support of local industries. The policy and activities of the Japanese Government of "targeting" the United States machine tool market and protecting and specially benefiting Japanese machine tool builders have been extensively documented. The Japanese Ministry of International Trade and Industry ("MITI") has worked closely with the Japan External Trade Organization ("JETRO"), the Japan Machinery Exporters' Association ("JMEA"), the Japan Society for the Promotion of Machine Industry ("JSPMI"), the Japan Development Bank ("JDB"), the Japan Bicycle Rehabilitation Association ("JBRA"), the Japan Motorcycle Rehabilitation Association ("JMRA"), the Japan Machinery Industry

Federation ("JMIF"), the Japan Machine Tool Manufacturers Association ("JMTMA") and other public, quasi-public and private organizations in sponsoring and directing programs that have specifically benefited Japanese machine tool builders. Examples of such programs and activities include:

-- promotion of the Japanese machine-tool cartel with explicit exemption from the Antimonopoly Law of Japan;[1]

-- subsidization of the Japanese machinery industry with funds in excess of $800 million a year from proceeds of wagering on races sponsored by JBRA and JMRA;[2]

-- preferential loans by JDB to Japanese machine tool builders, primarily for research and development and sales promotion, including below-market interest rates and government guarantees;[3]

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[1] The Japanese machine-tool cartel was formed in response to Japan Law No. 154 of June 15, 1956, Extraordinary Measures Law for Promotion of Machinery Industry. In addition to Law No. 154 of 1956, Japan has enacted two other special laws granting antitrust exemptions and special protections to the machinery industry: Law No. 17 of 1971, Extraordinary Measures Law for Promotion of Specific Electronic Industries and Specific Machinery Industries; Law No. 84 of 1978, Extraordinary Measures Law for Promotion of Specific Machinery and Information Industries.

[2] Letter dated November 10, 1982, to Donald deKieffer, General Counsel to the United States Trade Representative, from Houdaille Industries, Inc. See also Comments by Houdaille Industries, Inc., on the Section 103 Petition.

[3] GAO Japan Report, supra, at 30-33, 60-63; I. Magaziner and T. Hout, supra, at 92-94. See Comments submitted by Cincinnati Milacron to the International Trade Commission.

- special tax concessions for Japanese machine-tool capital expenditures, including an accelerated depreciation program designed specifically to subsidize high-technology NC machine tools;[1]
- technical research and development assistance to Japanese machine tool manufacturers provided by the Technical Research Institute of JSPMI;[2]
- promotion of the export of Japanese machine tools by JETRO and JMEA.[3]

The Japanese policy of actively protecting and promoting its machine tool industry has facilitated Japan's penetration of the United States market. Japan's share of the United States import market has more than doubled since 1976 from 21 percent to 44 percent, accounting for $529.2 million of sales in 1982.[4] The numerically-controlled machine tool sector has been especially hard hit by Japanese targeting practices, with Japan's share of the United States market increasing by 38.8 percent since

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[1] GAO Japan Report, supra, at 45-46, 61-64. See Comments submitted by Cincinnati Milacron, supra, Appendix 4.

[2] Comments by Houdaille Industries, Inc., on the Section 103 Petition, supra, at 21-30.

[3] I. Magaziner and T. Hout, supra, at 95-100. See Comments submitted by Cincinnati Milacron, supra, at 39-41.

[4] NMTBA monthly Import and Export Reports, based on U.S. Department of Commerce, Bureau of the Census, IM146 and EM522.

1980.[1] The United States Senate, in a "sense of the Senate" resolution, recognized that Japanese targeting practices have sought "domination" of the United States "high-technology industry in numerically-controlled machine tools" and that such practices are "a consequence of the discriminatory acts and policies of the Government of Japan."

The problems of United States machine tool builders have been exacerbated even further by the misalignment in the exchange rate between the dollar and the yen. There are indications that Japan has been pleased to tolerate the undervaluation of the yen in order that Japanese products might enjoy comparative price discounts in the United States.[2] The undervaluation of the yen and other foreign currencies has also hurt the sales of United States industrial manufacturers that are major customers of the United States machine tool industry. The result has been directly and indirectly to reduce the domestic demand for United States machine tools.[3]

The vigor of the Japanese campaign to dominate the United States machine tool market is revealed by the continued high level of Japanese shipments to the United States during the early part of 1982 even in the face of sharply declining domestic demand. As a result, the Japanese industry has amassed within the United States an inventory of NC machine tools that, according to Forbes magazine, contains an estimated "5,000 [to] 10,000 units worth as much as $500 million."[1] The Department of Commerce has also reported that "several thousand unsold Japanese machine tools remain stored in the United States, await[ing] a resurgence in U.S. demand."[2] Even the Japan Machine Tool Builders' Association has acknowledged that 2,500 of the 3,878 numerically-controlled lathes and 1,000 of the 2,180 machining centers shipped to the United States in 1981 are considered to be inventories.[3] Based on recent rates of production by the United States machine tool industry, inventories at the levels acknowledged by the Japanese association would represent approximately one and one-half years' production of NC lathes and almost nine months' production of machining centers.

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[1] Id., U.S. Dept. of Commerce, "Current Industrial Reports, Series MQ-35W, Metalworking Machinery" (Quarterly and Annual Summaries).

[2] See generally, Fair Practices in Automotive Products Act: Hearings Before the Subcomm. on Trade of the House Ways and Means Comm. 97th Cong., 2d Sess. 779 (1982) (statement of Beryl W. Sprinked, under Secretary of the Treasury for Monetary Affairs).

[3] See, Statement of Lee L. Morgan, Chairman, Task Force on International Trade and Investment, The Business Roundtable, on the Yen/Dollar Problem, before the Subcomm. on Trade of the House Ways and Means Comm. (November 30, 1982).

The reason for the buildup of Japanese inventory in the United States is unknown. The buildup may represent an attempt by the Japanese to administer a *coup de grace* to the domestic industry when the demand for machine tools finally revives. At that time, the Japanese -- who will have absorbed inventory carrying charges entirely beyond the reach of United States manufacturers --

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[1] "Industrial equipment and services," Forbes, Jan. 3, 1983, p. 130.

[2] 1983 Commerce Outlook, *supra*, at 20-1.

[3] American Metal Market/Metalworking News, June 28, 1982, p. 17.

will be able to satisfy orders instantly from stock, while American producers will have to scramble to rehire their work force before they begin to produce machine tools to fill new orders. The competitive advantange is obvious. Alternatively, the Japanese may have manufactured machine tools for which there was no current demand simply to achieve production experience and the cost savings that it produces, or to bolster Japanese employment.

Whatever the reason for the inventory buildup, there is cause for concern that the Japanese will emphasize even more than in the past the United States machine tool market. Given the trade barriers recently erected or being considered by the European Common Market,[1] it is probable that the Japanese production available for export will be targeted at the large United States market.

The American machine tool industry therefore is confronted with both a deep depression in demand and a "monstrous amount of machine [tools] overhanging the market" in the form of huge domestic inventories of foreign machine tools.[2] In these circumstances imports pose a serious deterrent to new investment in the United States machine tool industry. Such investment is critically needed to improve the industry's productivity and capacity and to bolster its research and development efforts. In the absence of such investment, the United States industry cannot maintain its technological prestige, which remains second to none in the world, but which is now being strenuously challenged.

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[1] "Fortress Europe Raises the Drawbridge," The Economist, Dec. 11, 1982, p. 47; The Economist, Feb. 19, 1983, p. 48.

[2] Also overhanging the market is a large quantity of relatively new, second-hand tools repossessed from financially troubled companies. Business Week, Oct. 18, 1982, p. 47.

C. Imports and the Current Depression have had Predictable Adverse Effects on the Production Capacity of the United States Machine Tool Industry.

The recent shift of demand to foreign machine tools, coupled with the current depression in the machine tool industry, with the resulting layoffs, plant closings and other cutbacks, has had predictable effects on the production capacity of the United States machine tool industry. As in the case of other industries, investment in new machine tool production capacity tends to follow increases in demand for the industry's products. To the extent that demand is diverted to foreign suppliers, investment in new domestic production capacity has been and will continue to be deterred.

To demonstrate the effect of imports on the industry's propensity to invest in new production capacity, DRI has examined the investment behavior of the domestic machine tool industry for 1982 and its projected investment behavior for 1983, and has contrasted this behavior with the investment decisions otherwise indicated under the hypothetical assumption that imports were entirely excluded from the domestic machine tool market for those years. Under this assumption, there is an increase in the size of the market satisfied by domestic production of machine tools. The results of this analysis are shown in Figure 24. As Figure 24 shows, the expansion of the market for domestic machine tools caused by the exclusion of imports would result in an increase in net capital investment of at least 50 percent above the level forecasted in the absence of exclusion and an annual increase in domestic production capacity of 9 to 10 percent.

D. In a Major National Emergency, the United States Could Not Count on Foreign Machine Tool Suppliers.

Imports of foreign-made machine tools seriously threaten to further debilitate the American machine tool industry. The practical effect of such debilitation would be to replace a significant part of the existing and potential machine tool production capacity in the United States with machine tool factories in foreign nations. At present, displacement would occur in favor of Japan and, to a lesser extent, the European Community; in the foreseeable future, there may be additional displacement to South Korea and Taiwan. The critical question, therefore, is whether such displacement would threaten to impair the national security. In other words, could the United States count on foreign machine tool suppliers during a serious national emergency?

The answer is no. The United States military has long sought to avoid "an unwanted reliance on overseas producers . . ., the worst effect of [which] . . . is that, if foreign supplies were denied to the United States during a mobilization emergency, the Government or private industry would have to recreate the productive capacity, with an attendant loss of time."[1] For the reasons stated above, if a serious military emergency occurs, it would probably be a conflict with the Soviet Union, and it is increasingly possible that such a conflict would be a protracted, possibly multi-theater, conventional war.

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[1] Report of Joint Comm. on Defense Production, 95th Cong., 1st Sess., Civil Preparedness Review, Part I, Emergency Preparedness and Industrial Mobilization 61 (Comm. Print 1977).

During such a war, sea and air lanes, which stretch 3,500 miles from the East Coast of the United States to Germany, and 7,500 miles from the West Coast to Japan, would be harassed or interdicted. As the Department of Commerce recently recognized, "under a full mobilization condition [transoceanic] shipping losses are estimated to be extensive."[1] The Secretary of Defense recently reported that "[t]he Soviet Union's greatly improved fleet gives it a capability to conduct an interdiction campaign against our shipping and naval forces in the Atlantic, Indian Ocean, and Northern Pacific. Soviet attack submarines and missile-equipped bombers would constitute a major threat in such a campaign, with missile-equipped bomber aircraft being particularly a threat in the Northern Atlantic, Arabian Sea, and Northern Pacific."[2]

Additionally, the machine tool production facilities in Asia and Western Europe, particularly Japan and the Federal Republic of Germany, could be subject to attack. Port facilities and internal transportation in those countries might be blocked or disrupted. Moreover, Japan, because of its proximity to the Soviet Union and distance from the United States, is vulnerable to intimidation. In short, if a serious national emergency arises, there is a substantial risk that the supply of new machine tools, critical components, and spare parts for older machine tools, from foreign sources would be radically reduced or completely halted just at the time that the demand in the United States for machine tools for military purposes would radically increase.

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[1] Investigation of Imports of Glass-Lined Chemical Processing Equipment, 47 Fed. Reg. 11,746, 11,753 (1982).

[2] Annual Report to Congress of the Secretary of Defense, Fiscal Year 1984, p. 26.

1. Japan. Tokyo lies only 700 miles from a major concentration of Soviet air and naval forces near Vladivostok, across the Sea of Japan; other parts of Japan are even closer. The Soviet Pacific Fleet, based in Vladivostok, includes approximately 120 deployed attack submaries, 80 deployed surface combat ships, and 300 fighter aircraft.[1] Long-range bombers are based nearby.[2] On the Soviet east coast there are "three times as many fighters . . . 'as the United States has in the entire Pacific air forces,'"[3] and "[i]n each of the past three years, [the Soviets] have added more aircraft in the Pacific than the total U.S. Air Force planes in the region."[4] The 46,000 troops, several warships and aircraft that the United States has stationed in Japan do not counter-weight the strength of the Soviet forces nearby.[5] In fact, "U.S. naval forces in the Pacific, because of expanded commitments in other

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[1] The Washington Post, Nov. 4, 1982, p. A32.

[2] Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, Attachment: "Soviet Military Power" at 7.

[3] The Washington Post, Oct. 1, 1982, p. A4, quoting "an Air Force spokesman."

[4] The Wall Street Journal, Nov. 22, 1982, p. 17, quoting Admiral Robert Long, Commander in Chief of U.S. Pacific Forces.

[5] "Today the Soviet Union is capable of pursuing a broad range of sophisticated sea-denial missions ranging from anticarrier operations to interdiction of [United States sea lines of communication]." Organization of the Joint Chiefs of Staff, United States Military Posture For FY 1983, pp. 44-45.

regions such as Southwest Asia, have been reduced to a post-World War II low. Our warships and submarines in the Pacific are about half of the 1965 level. The nuclear balance in the region has also shifted in favor of the Soviet Union."[1] "Whereas the U.S. could once deter the Soviets globally by itself, we can no longer go it alone," according to Admiral Robert Long, commander-in-chief of U.S. forces in the Pacific.[2] America's ability to protect Japan is further clouded by the substantial possibility that, in the event of a war in Europe or the Persian Gulf area, the United States almost certainly would be required to swing at least some of its Pacific forces to the European theater.

Japan's contributions to its own defense are inadequate. "The Japanese military consists of a localized 'self-defense force' . . . whose combined air, maritime and ground components total scarcely a quarter million men. . . . [It] has a minuscule, coastal defense navy whose entire tonnage is less than that of three American aircraft carriers, and whose principal combat ships are 48 small destroyers and 14 submarines."[3] Japan's military goal is only to "turn back 'limited and small scale aggression' as envisioned in the country's 1976 basic defense plans."[4] It has not yet realized even this limited objective. The Secretary of Defense has stated that today the Japanese forces "would have difficulty defending Japan,"[1] and that "Japan will have to do a very great deal more than they are now doing to fulfill this entirely self-defensive role."[2] America's commander-in-chief of Pacific Forces is more blunt: "In my judgment, they lack the ability to handle even a minor contingency."[3] Mr. Osamu Kaihara, a former deputy director of the Japan Defense Agency, stated that "[w]e have just a skeleton -- no real capability to fight."[4] The Economist recently dismissed the Japanese Self Defense Forces as a "defense system befuddled by the wrong rules and organization".[5] Consistent with this, the Under Secretary of State for Political Affairs has stated that "the Japanese should be doing more than they are now doing."[6] Not surprisingly, The Wall Street Journal reports that "[c]ritics say [Japanese] force-level projections adopted in 1976 were adequate then but aren't now, haven't been attained anyway, and won't be reached even by 1987 with currently projected spending."[7]

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[1] Report of the Secretary of Defense of Congress, Fiscal Year 1983, p. II-21.

[2] The Wall Street Journal, Nov. 22, 1982, p. 1.

[3] The New York Times, Jan. 4, 1982, p. 11.

[4] The Washington Post, Feb. 28, 1982, p. B2.

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[1] The Washington Post, Mar. 26, 1982, p. A28.

[2] The Washington Post, Nov. 4, 1982, p. A32.

[3] The Wall Street Journal, Nov. 22, 1982, p. 17.

[4] Id.

[5] "Kamikaze Pacifists," The Economist, Dec. 18, 1982, p. 12.

[6] Hearings on Department of Defense Authorization for Fiscal year 1983 Before the Senate Comm. on Armed Services, Cong., Sess. 1204 (1982) (statement of Lawrence Eagleburger). Similarly, Assistant Secretary of State John Holdridge was recently quoted as saying that "[w]e believe Japan can, and should, do more in the field of defense." The Wall Street Journal, Nov. 29, 1982, p. 27.

[7] The Wall Street Journal, Nov. 22, 1982, p. 17.

Japan, however, has persistently refused to expand its armed forces at anything more than a "glacial pace."[1] It has instead followed "an unwritten but widely accepted government guideline that defense outlays not be allowed to go beyond 1 percent of the country's gross national product."[2] Notwithstanding its ability to pay more,[3] and the United States' exhortations that it do so, Japan will spend only $11.11 billion for military purposes during the current fiscal year ending March 31, 1983.[4] That amount represents 0.93 percent of Japan's gross national product,[5] and only a four percent increase in real terms over the amount spent during the previous year.[6] According to Japanese defense officials, Japan's new five-year plan will probably keep defense spending at approximately one percent of GNP.[1] Consistently with their forecast, Japan has budgeted only $11.83 billion for defense during the 1983 fiscal year.[2] This paltry and "strategically aimless"[3] increase "will make it 'substantially impossible' to meet government weapons procurement plans outlined in the five-year program to begin next year" and will "create delays in purchasing the front-line military hardware necessary to keep plans to expand defense capabilities on track."[4]

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[1] The Washington Post, Dec. 30, 1982, p. A1.

[2] The Washington Post, July 24, 1982, p. A1; Id., Mar. 26, 1982, p. A28.

[3] Quoting "a Pentagon official," The New York Times reported that "'Japan is the only major industrialized nation that is spending less than it can afford' on defense." Id., Jan. 4, 1982, p. 11. Elsewhere, the Secretary of Defense has observed that Japan has "the free world's second largest economy [but] eighth largest defense budget." Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, p. II-21. See also page 232, infra.

[4] The Wall Street Journal, Dec. 30, 1982, p. 9. By comparison, the United States' military budget for 1983 is $216 billion. The New York Times, Mar. 27, 1982, p. 3.

[5] The Washington Post, July 24, 1982, p. A1.

[6] The New York Times, June 10, 1982, p. 3; Testimony of Frank Carlucci III, Deputy Secretary of Defense, Hearings on Department of Defense Appropriations, Sen. Appropriations Committee Subcommittee on Defense, Apr. 21, 1982. The most that can be said about the small increase in Japan's military budget is that the Japanese "are beginning to move, but it is at a pace that is slower than you and I would find acceptable." Id.

The foregoing facts indicate that in a major national security emergency, Japanese machine tool factories and transportation and port facilities would be seriously underdefended against a Soviet attack or blockade. For this reason alone, the United States cannot permit the displacement to Japan of United States facilities for the production of machine tools that would be needed in a serious national security emergency.

Even if the Soviet Union did not apply its superior military power directly against Japan, it could be expected to use that power to intimidate.[5] "The danger lies . . . in Soviet efforts to frighten Japan into neutrality."[1] Japan is peculiarly vulnerable to such intimidation because it is fundamentally pacifistic. Japan's refusal to maintain an adequate military force to defend its industrial wealth is grounded in an article of the Japanese Constitution that provides that "the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes. . . . The right of belligerency of the state will not be recognized."[2] In upholding Japan's contributions to the support of U.S. military facilities in Japan, the Supreme Court of Japan has indicated that, in view of "the pacifism which is the special characteristic of our Constitution," the use of military force by Japan is limited to "measures necessary for self-defense so that we can maintain our peace and security and preserve our existence."[3]

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[1] The Washington Post, July 24, 1982, p. A1.

[2] The Wall Street Journal, Dec. 30, 1982, p. 9.

[3] "Kamikaze Pacifists," The Economist, p. 12 (Dec. 18, 1982).

[4] The Washington Post, Dec. 30, 1982, p. A15, quoting senior Japanese defense analyst, Tomohisa Sakanaka and other senior government officials.

[5] "[E]ven when our adversaries do not actually fire weapons, they can exploit a preponderance of military power. They can coerce by threatening -- implicitly or explicitly -- to apply military forces . . . ." Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, p. I-10.

Consistent with its pacifistic constitution, the Japanese Government has declared "that Japan is constitutionally banned from exercising the right of collective self-defense on the ground that the constitution allows an act of self-defense as far as it is intended to defend Japan's own land and people, but does not permit Japan to cope with aggression against the land and people of a foreign national with which Japan has close relations."[1] Similarly, Japan's ambassador to the United States recently stated that if Japan ever acquires the military capability to close the straits that give the Soviet Pacific Fleet access to the Pacific Ocean, it would exercise that capability "only when Japan's security is threatened by direct and immediate threat from outside," because "[i]n terms of our constitution, we cannot be engaged in any kind of . . . collective security operation or effort . . . [and are] confined to the self-defense of Japan; not more than that."[2] Thus Japan has served notice that it is not a military partner of the United States in the real sense and that, if the Soviet Union attacks the United States' allies in Europe or the United States itself but not Japan, Japan will not assist the United States in "cop[ing] with [that] aggression."

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[1] The Wall Street Journal, Nov. 22, 1982, p. 17.

[2] Constitution of Japan, Art. 9.

[3] The Sunakawa Decision, Hanreishu, XIII (Dec. 16, 1959), reprinted in J. Maki, Court and Constitution in Japan: Selected Supreme Court Decisions 1948-60, at 302-03 (1964).

In a war between the Soviet Union and NATO, the Soviets could be expected to intimidate Japan with the threat of hostile military action, while at the same time offering to forbear from attacking Japan on the condition that Japan not use its industrial might to aid the West. Common sense and the Japanese constitution probably would incline Japan strongly to accept such an offer in order to protect Japan from attack. The decisive factor in this respect would probably be Japan's recognition of the Soviets' capacity to inflict punishing attacks on Japan, coupled with a perceived inability of the United States' Seventh Fleet to prevent such attacks.

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[1] Defense of Japan, 1980, White Paper of the Defense Agency of the Japanese Government, p. 87.

[2] The Washington Times, Mar. 2, 1983, p. C4 (Interview with Hon. Yoshio Okawara).

This argument may be wrong, and Japan might surprise us by her staunch behavior under pressure, but the balance of prudence argues overwhelmingly in support of the point made here. The burden of proof rests upon those who would contend that Japan, in a political context in which she had a choice, would take actions that would provoke Soviet hostile activity against her.

The possibility that Japan might reach an accommodation with the Soviets in time of war is further supported by the apparently deep pacifism of the Japanese people. The Gallup Poll recently found that only 22 percent of the Japanese are willing to fight for their country, as compared with 71 percent of Americans.[1] Moreover, "[a] recent poll conducted by the Japanese newspaper Asahi Shimbun showed 70 percent of the country taking a negative stance against the very modest Japanese military buildup now being proposed by the ruling Liberal Democratic Party."[2] If the Japanese people are, in the heavy majority, unwilling to fight for their country, it is difficult to assume that they would make any substantial sacrifice, in the name of friendship, to provide militarily essential supplies to the United States in wartime.

Japanese Prime Minister Yasuhiro Nakasone recently suggested the possiblility of a larger role for Japan in the defense of the Pacific region.[3] These remarks provoked an immediate "heated controversy" in Japan which "has confronted him with the first major test of his eight-week-old administration."[1] Even more disturbing was the reaction of the Soviet Union, which warned the Japanese that such measures "make Japan a likely target for a retaliatory strike . . . [which] for such a densely populated, insular country as Japan . . . could spell a national disaster more serious than the one that befell it 37 years ago."[2] This obvious reference to Hiroshima and Nagasaki, and the reaction it provoked in Japan,[3] clearly demonstrate that the Soviet Union would not hesitate to intimidate Japan in time of crisis should the Soviets find it advantageous to do so.

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[1] The New York Times, May 19, 1982, p. A-23.

[2] The Washington Post, Feb. 28, 1982, pp. B1-B2.

[3] The Washington Post, Jan. 19, 1983, p. A1.

Once Japan were forced into an accommodation with the Soviets, Japan could reasonably be expected to refuse to supply the United States with machine tools and other items necessary for its war effort. Japan could justify such a position on the ground that to provide such supplies would be an "act of belligerency" or involvement by Japan with respect to aggression not involving Japan, both of which it would claim are forbidden by its constitution. Or, Japan could take the position during wartime that, given the essentiality of machine tools for military purposes, they are subject to Japan's longstanding ban on export of military items. This absolute ban was recently reaffirmed by Japan's Minister of International Trade and Industry, notwithstanding Prime Minister

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[1] The Washington Post, Jan. 23, 1983, p. A1.

[2] The Washington Post, Jan. 20, 1983, p. A1.

[3] The Washington Post, Jan. 23, 1983, p. A10.

Nakasone's earlier suggestion that it might be relaxed in favor of the United States.[1]

Japan's heavy dependence on petroleum from the Persian Gulf further diminishes its reliability as a supplier of machine tools to the United States in a time of emergency. Eighty percent of the petroleum used in Japan comes from the Persian Gulf;[2] most of the rest comes from Indonesia. Whatever the source, Japan's supply lines for energy extend across thousands of miles of sea lanes, none of which Japan is prepared to defend. Japan's factories are therefore subject to shutdown as a result of turmoil in the the Persian Gulf area or as a disruption of shipping lanes incident to war involving the United States and the Soviet Union.

The conclusion to be drawn from the foregoing facts is not that Japan should be penalized for following a largely pacifistic course, which is its sovereign right. Instead, the proper conclusion is that due regard for the national security of the United States makes it impossible for the United States to tolerate the displacement of militarily essential American machine tool factories to Japan, which cannot assure any reliability of supply during a serious national emergency. Recognition of this reality does not denigrate the strong friendship between the United States and Japan, which flows in large part from the $63 billion in annual peacetime trade between the two countries, and from the important stability that United States-Japan relationship imparts to East Asia.

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[1] The Washington Times, Mar. 7, 1983, p. 6A.

[2] The Washington Post, Feb. 28, 1982, p. B2.

2. Federal Republic of Germany and Other European Nations. Notwithstanding America's strong and real alliances with the Federal Republic of Germany and certain other Western European members of NATO, the proximity of these countries to the Soviet Army and Air Force makes it impossible to count on them as suppliers of machine tools during a major national security emergency. In the face of a determined attack by Warsaw Pact forces, it would be difficult to defend major parts of Germany and the Benelux nations against rapid occupation, and impossible to maintain factory operations in, and export trade with, those countries.

There is considerable disagreement among defense professionals over the present and future ability of NATO to contain and defeat a Warsaw Pact invasion.[1] Regardless of which school of thought is correct -- and short of the test of battle there is no way of knowing who is correct -- there is consensus on the following relevant points:

- Massive damage will be inflicted upon the transportation infrastructure within and out of Western Europe.
- Economic activity in industrial NATO-Europe will be substantially disrupted or virtually halted "for the duration."

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[1] See, for example, John J. Mearsheimer, "Why Soviets Can't Win Quickly in Central Europe", 7 International Security, No. 1 (Summer 1982), pp. 3-39; and Anthony H. Cordesman, "M-X and the Balance of Power: Reasserting America's Strength," Armed Forces Journal International, December 1982, pp. 21-51.

- NATO-European countries will not be inclined to produce and transport machine tools (or other items) to enable the United States to mobilize to wage a protracted war.
- The sea and air lines of communication across the Atlantic will be strongly contested and probably disrupted.

E. Existing Programs for the Supply of Machine Tools During a National Emergency Are Inadequate for that Purpose.

The government presently relies on the Machine Tool Reserve, including Plant Equipment Packages, and the Machine Tool Trigger Order Program, to provide machine tools in the event of a national emergency. These programs clearly would not fill a breach caused by the closure of American machine tool manufacturing plants and their replacement by Asian and European plants. The Machine Tool Reserve is comprised of seriously obsolete equipment, much of which, moreover, is inoperable. The Trigger Order Program can work only if there are healthy American machine tool builders available to respond to the trigger orders when they come; in the meantime, the program provides no inducement or assurance that the American machine tool industry will maintain its strength or existing production capacity. Neither can mobilization planners and officials of the Department of Defense assume that a substantial portion of the machine tools in place in factories producing civilian goods could readily be used to produce armaments and other military items in the event of a national security emergency.

The machine tools in factories today are, for the most part, either too obsolescent or too highly dedicated to other uses to permit their use for the manufacture of modern armaments.

In the event of a national emergency, the machine tool stockpile would be at most marginally useful because its components are generally obsolete or inoperable. Many of the machine tools presently in use for the production of civilian goods could not readily be diverted to military production. The Trigger Order Program assumes, but does not provide for, adequate domestic machine tool production capacity to meet national security needs, and the number of machine tools that are proposed to be included in contingent "trigger order" contracts is but a fraction of those that would be required in a serious national security emergency. Therefore, any harm to the national security caused by the debilitation of the domestic machine tool industry will not be offset by the Trigger Order Program, the Machine Tool Stockpile, or the redeployment of machine tools presently used to make goods for civilian consumption.

F. Because of Imports and the Current Depression, the United States Machine Tool Industry Lacks the Capacity Needed to Meet a Major National Security Emergency.

The domestic industry's normal production capacity (*i.e.* the economist's definition of capacity) is probably adequate to satisfy the requirements both of the peacetime defense buildup and of a limited war -- on the assumption, in both cases, that imports would continue to be available. But the industry's maximum production capacity (*i.e.* the engineer's definition of capacity), under full mobilization conditions, is seriously inadequate to satisfy the requirements of a large-scale conventional war.

DRI has projected that the U.S. machine tool industry together with imported machine tools, would have the capacity, in the absence of the requested relief, to supply enough machine tools to satisfy the demands of accelerated peacetime defense spending or a "Vietnam-type" limited war, in which imports are not interdicted..

Figure 25 shows the projected potential supply of machine tools for the years 1983 through 1987, expressed in 1972 constant dollars, with potential supply determined on the assumption that imports are unavailable in a large-scale conventional war[1] and that the industry operates under emergency mobilization conditions, and compares that supply with the conservatively-stated projected demand for machine tools during the same period on the assumption that mobilization for the large-scale conventional war begins in 1983, that the war itself begins in 1984 and continues through 1986, and that demobilization occurs in 1987.

DRI has forecasted that new domestic production capacity[2] will be brought on stream, in response to aggregate demand including the increased demand attributable to the war effort, at the rate of 18.5 percent during 1983, 10.9 percent during 1984, 19.8 percent during 1985, and 15.4 percent during 1986, for an aggregate increase through 1986 of 81.4 percent. (Capacity declines by one percent during 1987, the year of demobilization.) Despite these additions to capacity, however, a tight supply situation would arise as early as 1984, and by 1985 there would be a substantial and growing gap, as Figure 25 shows. Backlogs and lead times would increase, disrupting military procurement. Even though military requirements would be given priority,[1] it is certain that military production would be subject to substantial, and unacceptable, delays. Moreover, given the virtual certainty that foreign sources of supply would be denied to the United States imported machine tools would not be available to fill the production "gap."

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[1] It is assumed that imports and exports are cut off by war conditions.

[2] For this purpose, capacity is defined as emergency production capacity.

Figure 26 is similar to Figure 25 except that it assumes that the large-scale conventional war occurs during the years 1989 through 1991, with mobilization for the war beginning in 1988.

In this case, as Figure 26 shows, the machine tool bottleneck occurs earlier -- in 1988, the year of mobilization -- both because imports will have gained a larger share of the domestic market (in the absence of import restrictions) and because the domestic industry will have less idle capacity than it has currently.

The national-security implications of this situation are grave -- the simple fact is that the United States' ability to deter or to respond promptly and effectively to a protracted conventional war is already open to serious question.

VI. THE IMPOSITION OF QUOTAS WILL REDUCE THE THREAT TO NATIONAL SECURITY

The remedy that NMTBA requests will help to restore the vigor and preserve the technological primacy of the United

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[1] Priority for defense-related production could be ordered under the Defense Production Act, 50 U.S.C. App. § 2071; existing machine tools could be requisitioned under that Act, 50 U.S.C. App. § 2081.

States' machine tool industry, so that it will be able to respond strongly and rapidly to any national security emergency. Moreover, the remedy will provide for some immediate increase in the industry's production capacity. The requested remedy therefore serves the fundamental national security objectives of strengthening the United States' deterrence posture and preserving its ability to respond promptly and effectively to an attack upon its interests and to sustain a defense, if necessary, during a protracted conventional war.

A. The Imposition of Quotas Can and Will Increase the Domestic Production Base.

DRI has calculated the level of quotas that would be needed to induce new investment to increase the domestic production base by 10 percent by 1987 over the base that is projected to exist that year in the absence of relief. The tradeoff between imports and capacity is shown in Figure 27; imports must be restricted to 17.5 percent of the domestic market in order to achieve a 10 percent increase in machine tool production capacity.

If machine tool imports are limited to 17.5 percent of the domestic market in both the metal-cutting and metal-forming sectors, the resulting increase in demand for domestic machine tools will induce new investment in plant and equipment, over and above what would be invested in the absence of quotas, in the projected amount of $91 million (1972 dollars) over the five-year period from 1983 through 1987. This is shown in Figure 28.

As Figure 29 shows, this new investment in plant and equipment will increase our domestic emergency production capacity, over and above the capacity that would exist in the absence of quotas, to the extent of approximately $434 million (1972 dollars) of annual production capacity by the end of 1987.

The additional production capacity shown in Figure 29 would represent a net increase of 10.0 percent in the nation's overall machine tool emergency production capacity. In the case of a large-scale conventional war for which mobilization begins in 1988, this additional capacity will enable the domestic machine tool industry to satisfy demand, including defense-related demand, during the critical mobilization year and the early stages of fighting notwithstanding the loss of imports. This is shown in the right-hand panel of Figure 30. In practical terms, the "cost" of this benefit is a possible tightness of supply in the latter stages of the five-year period (before 1988) during which quotas are in place. As noted earlier, however, the industry has demonstrated that it can operate at higher-than-normal rates when conditions require; Figure 30 shows that the industry's potential "engineering" supply (emergency production capacity) substantially exceeds projected demand. Moreover, it is likely that any tightness of supply could be managed -- certainly in a more orderly fashion during peacetime than after the outbreak of war -- either by proper phasing of Department of Defense procurement or, if necessary, by future adjustment of the quotas imposed on imports.

Figure 31 combines the data from the right-hand panels of Figures 26 and 30. It shows the amount of domestic demand, including military demand, during the years 1988 through 1991 and compares it with the supply that is projected to be available during those years depending on whether or not quotas have been imposed during the years 1983 through 1987.

Figure 32 shows, on a year-by-year basis during the war years, the excess of potential supply over demand, or the excess of demand over potential supply, as the case may be, during the years 1988 through 1991 depending on whether or not quotas have been imposed during the years 1983 through 1987.

Because the domestic machine tool industry is highly competitive, the imposition of the quotas requested by the Petition will not result in material increases in prices over the levels that would be likely to occur in the absence of quotas. DRI has analyzed the rate of price increases that are likely to occur for the years 1983 through 1987 with and without quotas. Figure 33 shows that the projected prices for machine tools if quotas are imposed are not likely to exceed the prices that are projected in the absence of quotas by more than approximately two percent in any year. In most years, the projected price differential is negligible; factors holding down prices include competition between domestic producers, the large overhand of Japanese machine tools in inventory, the idle capacity that currently exists in the industry, and continued, albeit reduced, competition from imports. Again, the flexibility of a quota system provides a possible solution for any unacceptable price pressures; quotas can, if necessary, be modified to suit future conditions.

B. The Requested Relief is the Most Cost-Effective Way to Revitalize the Ability of the U.S. Machine Tool Industry to Support the National Security.

The requested relief should be granted immediately if it is to have its intended, fully potent effect on the machine tool industry. A deferral of relief will simply make the problem worse and the remedy more costly. The industry still retains substantial residual strength that will permit it to repond if current trends are reversed in time. Among other things, the United States is still generally recognized as the leader in machine tool technology. Foreign builders have so far succeeded principally by copying American product innovations more cheaply, not by developing their own new products. The United States still offers a wider range of machine tool products than the industry in any other country. It would be most unfortunate to lose this advantage. Moreover, the industry's plant and equipment and skilled labor force, while weakened or reduced, are still sizeable. In these circumstances, it will be far easier to reverse the present adverse trends before they have further weakened the industry, rather than to try to rebuild this industry after it has declined.

The relief is essential to the interests of national security and is justified on that basis alone. Moreover, the economic costs of granting the relief are not disruptive. If imports are restricted to 17.5 percent of the U.S. market over the next five years, DRI estimates that real GNP growth will be increased by a minimal 0.06 percent and net economy-wide employment will increase by approximately 20,000 jobs. Inflation, as measured by the GNP implicit price deflator, will increase marginally by only 0.07 percent per year.

C. The United States Machine Tool Industry Recognizes That Self-Help Is a Necessary Adjunct to the Requested Relief.

While NMTBA and its members are convinced that the relief they have requested is absolutely essential to the revitalization of the American machine tool industry, they recognize that the relief, by itself, will not accomplish that goal. A vigorous program of self-help by the industry is required, and it is already underway. The full implementation of the program, however, will require investment from cash flow, equity and debt financing sources. Much of that investment cannot be arranged until the serious uncertainty about the future vitality of the machine tool industry is diminished by a grant of the requested relief.

The industry has not ignored its problems and the formidable challenges it faces. In response to the precipitous rise in imports from Japan, which began in 1975, a group of leaders of the American industry examined in great detail the methods of the Japanese industry. This group, called the NMTBA Japanese Study Mission, published in September 1981 a report that forthrightly recommended that the American industry adopt certain principles of management to assure its continued existence and vitality.[1] Specifically, the report recommended that the American industry should: (1) invest aggressively in the latest, most efficient means of production that incorporate the newest manufacturing technology, to improve productivity and reduce costs, thereby foregoing short-term returns in favor of long-term objectives; (2) make heavy investments in research and development to devise new products; (3) increase dramatically its emphasis on every aspect of quality in design, manufacture, application and service; (4) develop extensive programs to motivate, build trust and instill pride in their workforce, including sincerity in communication and participation by the workforce in work place activities; and (5) take an aggressive world-marketing approach to maximize exports to foreign markets.[1]

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[1] Report of the Japanese Study Mission of the National Machine Tool Builders' Association: "Meeting the Japanese Challenge," Sept. 14, 1981.

Within the severe limits imposed by the present depression in the industry, American machine tool builders have begun to respond to these recommendations. It is broadly recognized that there must be heavy investment in improvements in the productivity of machine tool plants, and in expansion of capacity so that the domestic industry can be competitive with respect to lead times.

Examples are provided in the 1981 Annual Reports of certain publicly held machine tool companies. White Consolidated Industries, Inc. reported that "[i]n order to maintain cost effective manufacturing in our Machine Tool Group, we currently are spending on capital improvements at about four times our depreciation rate" and recognized that "[m]assive investments in people, plant and equipment, plus research and development will be necessary for U.S. companies to meet worldwide competition in the marketplace." (Page 15). Brown and Sharpe Manufacturing Company reported its "willingness to continue investing in capital expenditures for re-equipment at a high rate throughout 1981 [during which] $14,271,000 was spent on such projects with a heavy emphasis on the purchase of modern computer-controlled equipment wherever feasible." (Page 3). Acme-Cleveland Corporation acknowledged that "we need to build new plants and develop new products and technology to provide the basis for achieving and sustaining a much higher level of earnings performance over the longer term." (Page 4). Cincinnati Milacron, Inc., reported the opening of a new plant for the production of machining centers in Fountain Inn, South Carolina and stated that "our major emphasis continues to be installation of new machines and systems to increase productivity throughout our operations." (Pages 3-4). Giddings and Lewis, Inc. reported that "[w]e will continue to expand efforts in research and product development, along with investments in plants and equipment. We are committed to building for long-term growth and return to our shareholders. We will not sacrifice the future for short-term results." (Page 2).

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[1] Id., pp. 6-7.

The 1981 Annual Reports contain the following examples. Brown and Sharpe Manufacturing Company reported "active new product development and manufacturing systems improvements now underway [which] are, in our judgment, absolutely required to keep pace with world competition today[;] accordingly, these expenses have been maintained undiminished." (Page 6). White Consolidated Industries, Inc. reported that "[r]esearch and development budgets also were up in 1981, as we aggressively developed new products to serve growth industries and sought new markets for existing product lines." (Page 15). Giddings and Lewis, Inc. stated that "[r]esearch and development spending will continue at the present level of 4.5% or more of machine tool sales. As a result of that ongoing program several new products will be introduced at the 1982 International Machine Tool Show in Chicago." (Page 9). Ex-Cell-O Corporation reported that it is "placing a higher priority on stimulating technical creativity and new product development."

(Page 3). The Gleason Works reported "research and development costs which amounted to $6,029,000, $4,225,000 and $4,330,000 in 1981, 1980 and 1979, respectively. These expenditures reflect the Company's continued emphasis on the development of new products and technologies." (Page 16). Cincinnati Milacron, Inc. reported that it had undertaken construction of a new $6.8 million technical center "to further expand R&D" and would "increase R&D spending significantly in 1982" over the $31 million spent in 1981. (Pages 28-29). Cross and Trecker Corporation stated that its "emphasis in the 1980's will be on product development. . . . We will expand our capabilities through developing or acquiring new technologies. . . . In computer controls, more intriguing developments lie ahead for the machine tool industry. We are increasing our emphasis there, and in 1981 we created a new technology organization to pursue that and other research and development efforts." (Pages 3, 7). "We have not curtailed research and development and do not anticipate doing so," declares Clifford R. Meyer, president of Cincinnati Milacron Inc. Other machine-tool builders also say that R&D is the last thing on their budgets that will get axed."[1]

Similarly, Acme-Cleveland Corporation "has invested $7.4 million in five small entrepreneurial ventures that range from laser systems and robotics to computer-aided design and manufacturing."[2]

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[1] "The Vise Tightens on Toolmakers," Business Week, Dec. 6, 1982, p. 63.

[2] "Industrial equipment and services," Forbes, Jan. 3, 1983, p. 130.

More attention has been given to the quality of service provided to the end users of American-made machine tools.

For example, Cincinnati Milacron reported in its 1981 annual report that, "'[h]igh tech', products must be supported by equally 'high tech' marketing, sales and services . . . . [W]e have about 700 technically trained people working with customers in the U.S. . . . They, in turn, are backed by factory-based specialists. These experts are also available to train our customers." (Page 28). Consistently, Business Week recently reported that:

> "[A] number of toolmakers are redirecting their marketing efforts. The most dramatic is [Cincinnati] Milacron's move to reach out, especially to its smaller customers, through regional technical centers that include not only machinery showrooms but also computer links to headquarters. This will allow customers to test new programs and even machine sample parts. 'We are going to bring the product to the user,' says Milacron's [president, Clifford R.] Meyer. . . . Other builders, such as Bendix and Textron Inc.'s Bridgeport Machines Div. are revamping their distribution systems to reach customers more easily. And most are beefing up their customer financing activities." "The Vise Tightens On Toolmakers," Business Week, Dec. 6, 1982, p. 64.

In addition, NMTBA is itself seeking to improve the ability of distributors to provide service for American-made machine tools. NMTBA sponsored technical seminars at the International Machine Tool Show held in Chicago in September 1982 and is planning similar seminars for the Rock Island and Watervliet Arsenals of the United States Army, major recent customers of the United States industry. Acme-Cleveland Corp. has recently invested substantially in remanufacturing and metrology facilities.

Moreover, the American machine tool industry has attempted aggressively to recover positions in foreign markets.

In short, the United States machine tool industry is keenly aware that the relief requested in its Petition will, in the words of NMTBA's President, simply afford the industry a necessary "breathing spell."[1]

At the same time, however, it must be emphasized that there are no reasonable bases for expecting that self-help, by itself, can restore the domestic machine tool industry to health. The present relative strengths of our foreign competitors, including their ability to supply cheap tools on short notice from bulging domestic inventories and to continue to expand their capacities and productivity notwithstanding the current depression in the United States market, present an ongoing threat that must be met. There is a serious prospect that, in the absence of relief, the American industry will suffer debilitating, long-term reverses that will destroy its substantial latent strength and frustrate its potential for reinvigoration.

D. The Relief Will Not Harm the National Security.

It can be expected that some foreign economic interests or governments opposing our Petition may attempt to couch their arguments in terms of the United States' national security interests, by suggesting that the relief we seek might upset friendly international relations.

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[1] "America Needs You," Address of James A. Gray, President, National Machine Tool Builders' Association, at NMTBA's Annual Meeting, Nov. 11, 1982, p. 3.

However, it cannot be disputed that in a military sense, the survival of the Free World including the nations affected by the requested relief depends on the strength of the United States. In peacetime, the prosperity of our friends and allies has depended on freedom of the seas and the general stability of the world order that American military strength has provided. In time of war, Japan and parts of Western Europe, including Germany, would, because of their geographical positions, be vulnerable to surprise attacks by the Soviet Union and its allies that could temporarily sweep them under Soviet control, or deny their access to the West. Given that fact, and given that liberation of Soviet-occupied territory might be impracticable in the nuclear context, allies of the United States who are strategically exposed by reasons of geography should look with favor on United States policies that will strengthen deterrence. The productive capability of the United States defense industry is an American "long suit" for deterrence in Soviet eyes. Soviet respect for American defense-industrial mobilization potential is genuine, to date has been well-founded, and should be exploited in the future to diminish the credibility of briefings in Moscow that promise victory in short war.

Therefore, the United States has not only a statutory duty to its people to preserve its military strength, but also a similar fiduciary duty to its allies, such as Germany and the other NATO countries, and its friends, such as Japan, to deter aggression and to be prepared, if necessary, to intervene on their behalf. In short, the relief that NMTBA requests will serve the broad and fundamental interests of our friends and allies.

Moreover, a grant of relief under the National Security Clause in the compelling circumstances of the machine tool industry cannot offend Japan, which has only recently justified the protection of some of its agricultural products on the ground that "national security would be endangered if the country were totally dependent upon imported food."[1] Indeed, the United States has acknowledged the legitimacy of Japan's position. According to David MacDonald, Deputy United States Trade Representative, the Japanese have a "'legitimate concern for the issue: will we have food if there is a world crisis and the trade stops,'" and the "national security argument" that the Japanese have made on the basis of this concern is "certainly . . . valid."[2]

It is equally certain that the United States should have a legitimate concern whether it will be able to manufacture an adequate number of armaments and other equipment to support its troops if there is a world crisis and trade stops. To protect against this possiblity, the United States may erect barriers to the import of machine tools that threaten to debilitate the domestic machine tool industry. While food may be the paramount concern of the densely populated island nation of Japan, maintenance of the ability to produce the weapons necessary to deter aggression by the Soviet Union is a paramount concern of the United States. Indeed, in that regard, the United States bears an obligation that is unique among the nations of the world. The long-standing claim, that is virtually a cliche' by reason of its longevity and familiarity, that the United States is the "Arsenal of Democracy," is more apt looking to the mid- and late-1980s and the 1990s than it ever was in World Wars I and II.

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[1] 423 U.S. Export Weekly 813 (Sept. 7, 1982).

[2] Id.

Furthermore, although the machine tool industry is essential to the successful military mobilization of the United States, it is a small industry that accounts for but a minute fraction of the volume of trade with nations such as Japan and Germany.[1] Therefore, the requested relief does not threaten to disrupt existing trade relationships.

There are, in addition, principles of fairness that favor the relief that NMTBA requests. Japan's contribution to the military defense of Western interests is, and has long been, much less than the United States contribution,[2] even though Japan depends totally on, and has prospered awesomely from, the interests that the American military protects.[3] "[Japan] has as much at stake in the security of free democracies as Europe has in the continuing strength of the United States. Yet Japan contributes almost nothing towards that security, while its allies strain to find the money to keep abreast of military spending in the Soviet Union."[1] It is therefore not unreasonable to expect Japan to bear the very modest burden of a grant of relief pursuant to the Petition, which would strengthen the national security of the United States. Similarly, while the contributions of Western European nations to defense have far exceeded Japanese contributions, they have lagged far behind those of the United States. This is shown in Figure 34.

---

[1] Machine tool imports in 1982 from Japan and Germany accounted for less than 2 percent of all merchandise imports from those nations. U.S. Department of Commerce, 62 Survey of Current Business, No. 12, p. 44, and Import Report IM146 (1983).

[2] "The Japanese have spent less than 1 percent of their gross national product on defense since the late 1960s, while the United States has spent between 6 and 10 percent of its GNP on defense during this period. The average American taxpayer spends $759 a year on defense; the average Japanese, $98." The Washington Post, Feb. 28, 1982, p. B2.

[3] "Japan has prospered under the security provided by the U.S. defense umbrella and had developed into an economic superpower capable of assuming a greater share of common defense costs." Prepared Statement, General Accounting Office, International Division, Hearings on Department of Defense Appropriations Before the Subcomm. on Defense of the Senate Appropriations Comm., Apr. 21, 1982.

Additionally, Japan and many nations of Western Europe have been lax in enforcing international standards prohibiting the sale of militarily significant high technology equipment, including machine tools, to the Soviet Union and its allies;[2] by contrast, the enforcement of the standards by the United States has been strict. The consequence has been to weaken the defense posture of the West.[3]

---

[1] "Kamikaze Pacifists," The Economist, Dec. 18, 1982, p. 11.

[2] For example, in 1981 the delegation from the United States machine tool industry that observed the facilities and practices of the Japanese industry reported that:

> "(M)achine tools sold to Socialist nations require the same types of licenses as in the U.S. However, obtaining them is a much different matter. Licenses for shipments to the USSR take about one month for a 5-axis machine tool. . . . The companies questioned stated that they have never had a license denied." Meeting the Japanese Challenge, Japanese Study Mission of National Machine Tool Builders' Association, Sept. 14, 1981 at 28.

[3] Annual Report of the Secretary of Defense to Congress, Fiscal Year 1983, p. I-22.

The Secretary of Defense recently pointed out the dollar burdens that fall primarily on the United States as a consequence:

> "[E]ven an increase in U.S. investments [in military items] as high as 14 percent per year would not close the gap [between the West and the Soviet bloc in accumulated military] assets until the early 1990s. The gap could be closed more quickly if U.S. investments provided qualitative innovations that increase the rate of obsolescence of past Soviet investments. This point highlights the importance of research and development and of policies to protect our technological lead.
>
> Technology transfer from the West to the Soviet bloc, in effect, increases our defense burden."[1]

Similarly, the Central Intelligence Agency has reported that

> "it is clear that the Western military expenditures needed to overcome or defend against the military capabilities derived by the acquisition of Western technology far outweigh the West's earnings from the legal sales to the Soviets of its equipment and technology."
>
> CIA Report on Soviet Acquisition of Western Technology, Apr. 1982, quoted in Transfer of United States High Technology to the Soviet Union and Soviet Bloc Nations, Report of the Perm. Subcomm. on Investigations of the Senate Comm. on Governmental Affairs, S. Rep. No. 97-664, 97th Cong., 2d Sess. 5 (1982).

Moreover, as a consequence of disparate enforcement of the export restrictions, the United States machine tool industry has suffered competitively. The requested relief tends to redress this unfairness.

Finally, neither Japan nor the nations of the European Common Market can reasonably complain that the requested relief is somehow irregular because it destroys the freedom of international machine tool markets. Outside the United States, free markets in machine tools have never been the norm. The present strength of the Japanese machine tool industry is the result of massive government subsidies and government-led industrial coordination and organization. Similar subsidies favor producers in the Common Market countries.

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[1] Id. at II-7.

VII. CONCLUSION

The threat to national security can be measured by the delay in mobilization that would be caused by the inadequate production capacity of the domestic machine tool industry. The amount of delay that is tolerable from the national security standpoint is of course a matter for defense planners and ultimately the President to determine. It is a matter of record, however, that severe delays and bottlenecks attributable to the machine tool industry were experienced in prior wars, and it is obvious that any delays, even short ones, are potentially detrimental to the national security and weaken the United States' deterrence posture.

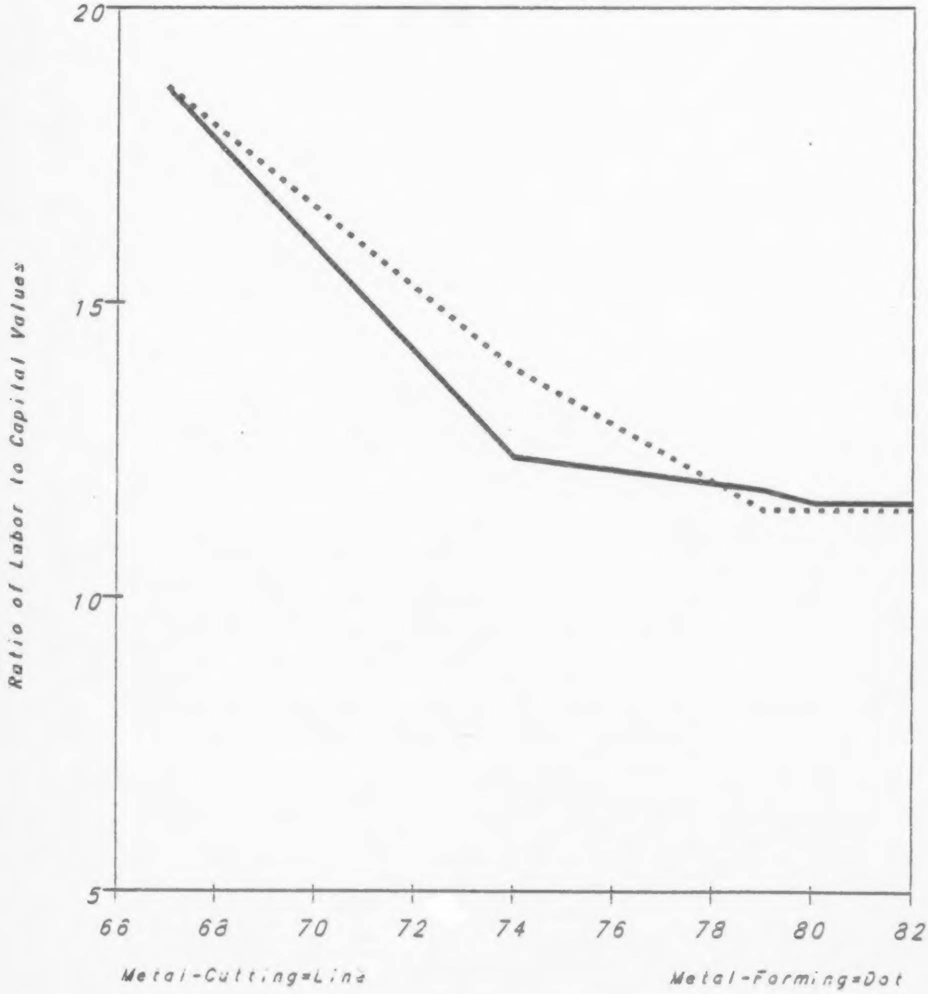
NMTBA believes that the mobilization problems in a future war are likely to be more severe than in the past both because there may be less time for mobilization and because it may be more difficult than in the past to convert existing machine tools to defense-related production. The problem today, moreover, goes beyond mere delays and restricted production capacity. Sophisticated production processes, and sophisticated weapons systems, require nothing less than a domestic machine tool industry that is at least equal to the world's best. If imports continue to rise, the United

States industry -- long the world leader -- is in danger of losing its technological edge along with its production capacity.

For the reasons stated, NMTBA submits that imports of machine tools are impairing, and threaten to continue to impair, the national security and that, under Section 232, action must be taken to adjust the level of imports so that they do not impair or threaten to impair the national security.

FIGURE 1

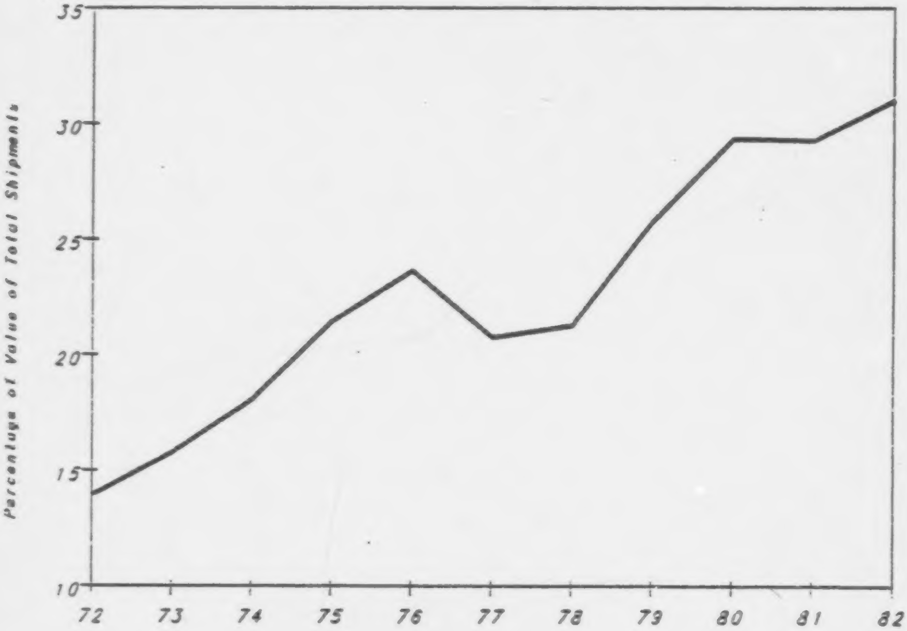
Ratio of Labor to Capital Values
for Machine Tools
1967-1982



Source: DRI Machine Tool Model (1983).

FIGURE 2

Value of U. S. Shipments of
Numerically Controlled Machine Tools as a
Percentage of Value of Total U. S. Machine Tool Shipments
(For machines valued over $1,000 1972-77 and
over $2,500 1978-82)

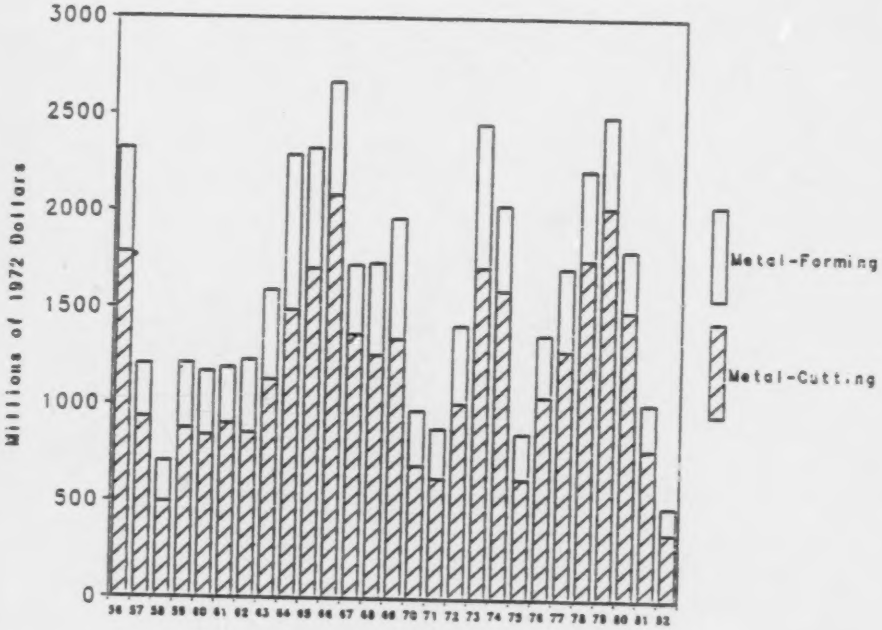


Source: U. S. Department of Commerce, 'Current Industrial Reports, Series MQ-35W, Metalworking Machinery' (quarterly and annual summaries).

Note: 1982 data are for first three quarters.

FIGURE 3

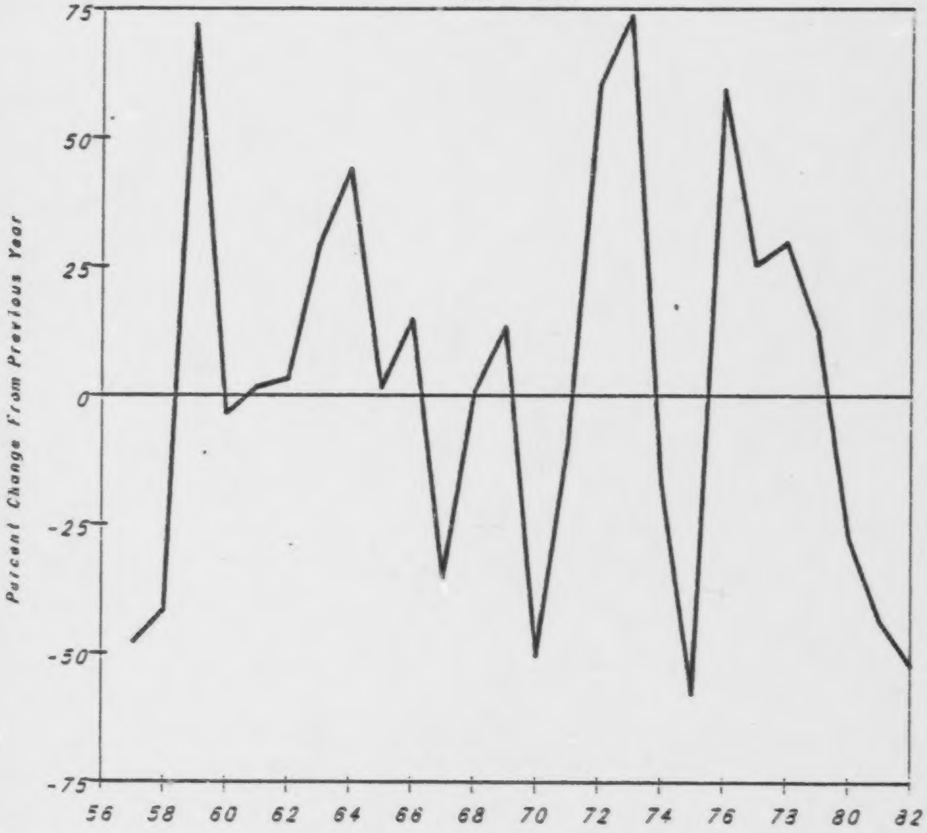
Net New Orders for Machine Tools
Received by U. S. Builders
(1972 Dollars)
1956-82



Source: NMTBA 'Economic Handbook of the Machine Tool Industry, 1982-83' and NMTBA 'Industry Estimate of Machine Tool New Orders, Cancellations, Shipments and Backlog' (monthly).

Adjusted using Bureau of Labor Statistics (BLS), U. S. Department of Labor, Producer Price Index for respective sector, re-based to 1972=1.00.

FIGURE 4

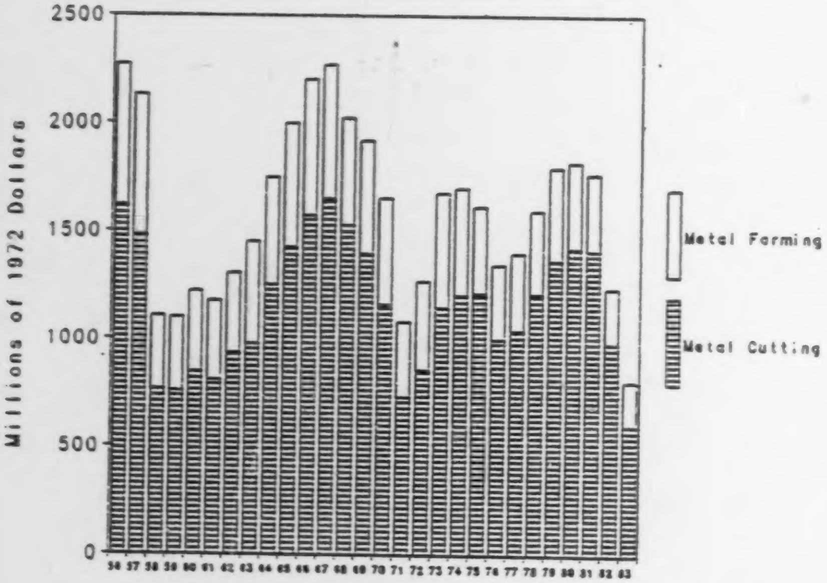


Year-to-Year Change in Real Net New Orders of Machine Tools 1957-1982

Source: NMTBA 'Economic Handbook of the Machine Tool Industry, 1982-83' and NMTBA 'Industry Estimate of New Orders, Cancellations, Shipments and Backlog' (monthly).

FIGURE 5

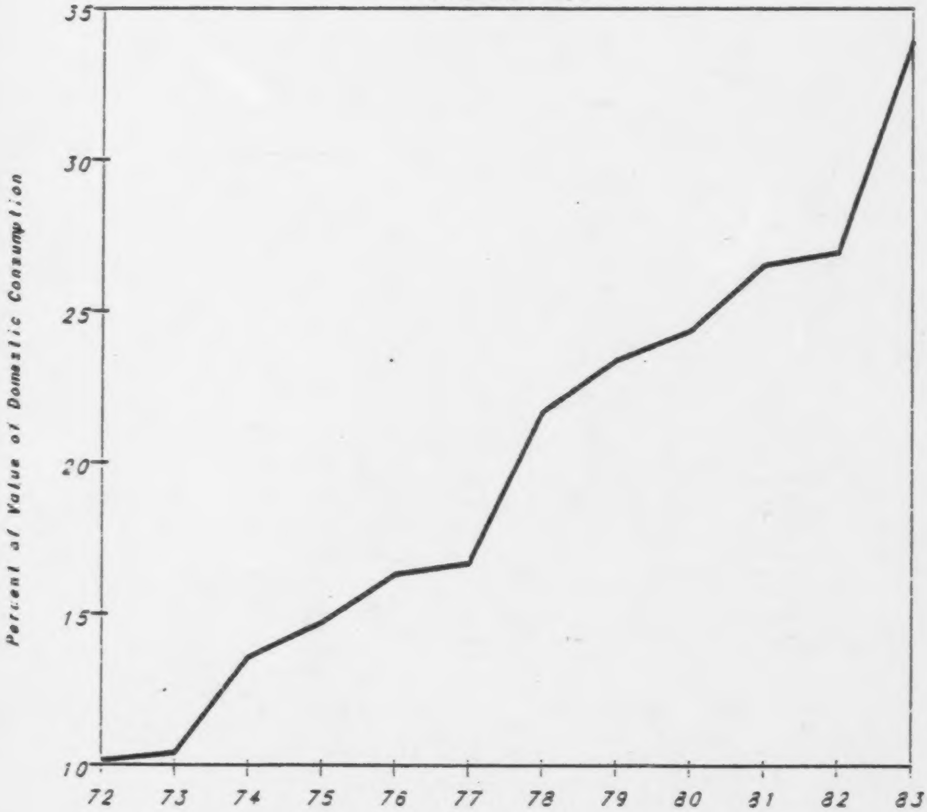
Shipments of Machine Tools
by U. S. Builders
(1972 Dollars)
1956-83 (a,b)



Source: U. S. Department of Commerce, 'Current Industrial Reports, Series MQ-35W, Metalworking Machinery.' Adjusted using BLS Producer Price Index for respective sector, re-based to 1972=1.00

(a) 1982 estimated using 3rd quarter figures for 4th quarter.
(b) 1983 forecast based on '1983 U. S. Industrial Outlook', U. S. Department of Commerce (1983).

FIGURE 6



Import Share of Value of U. S. Domestic Consumption of Machine Tools 1972-83 (a,b)

Source: U. S. Department of Commerce. 'Current Industrial Reports', Series MQ-35W, Metalworking Machinery (quarterly and annual summaries) and Series IM-146 and EM-522 (monthly).

(a) 1982 data are for first three quarters.

(b) 1983 forecast based on '1983 U. S. Industrial Outlook', U. S. Department of Commerce (1983).

FIGURE 7

IMPORT PENETRATION OF THE U.S. MACHINE TOOL MARKET

FIRST THREE QUARTERS OF 1982

PRODUCT TYPE	IMPORT % UNITS	IMPORT % VALUE
TOTAL INDUSTRY	43.7%	27.0%
TOTAL METAL CUTTING	48.4%	27.8%
BORING MACHINE	80.1%	24.9%
DRILLING	44.5%	22.3%
GEAR CUTTING	78.9%	34.1%
GRINDING ETC.	39.2%	24.9%
HORIZONTAL NC TURNING	72.0%	51.2%
VERTICAL NC TURNING	67.0%	29.0%
NON NC TURNING	54.2%	49.6%
MILLING	47.8%	23.3%
MACHINING CENTERS	64.4%	38.8%
STATION TYPE	7.3%	0.8%
OTHER METAL CUTTING	24.7%	32.8%
TOTAL METAL FORMING	26.1%	22.9%
PUNCHING & SHEARING*	36.2%	33.3%
BENDING & FORMING*	20.8%	21.5%
PRESSES	19.1%	11.7%
FORGING	49.9%	28.8%
OTHER METAL FORMING	25.1%	42.0%

Source: U.S. Department of Commerce, 'Current Industrial Reports Series MQ-35W, Metalworking Machinery,' Import Report IM146 and Export Report EM522.

Note: Data includes only machines valued $2,500 or more. A listing of the Standard Industrial Classification, TSUSA and Schedule B code numbers for these products appears in Appendix B.

* Imports amounted to 48.4% of the value and 24.7% of the units of domestic consumption of NC Punching, Shearing, Bending and Forming machines.

FIGURE 8

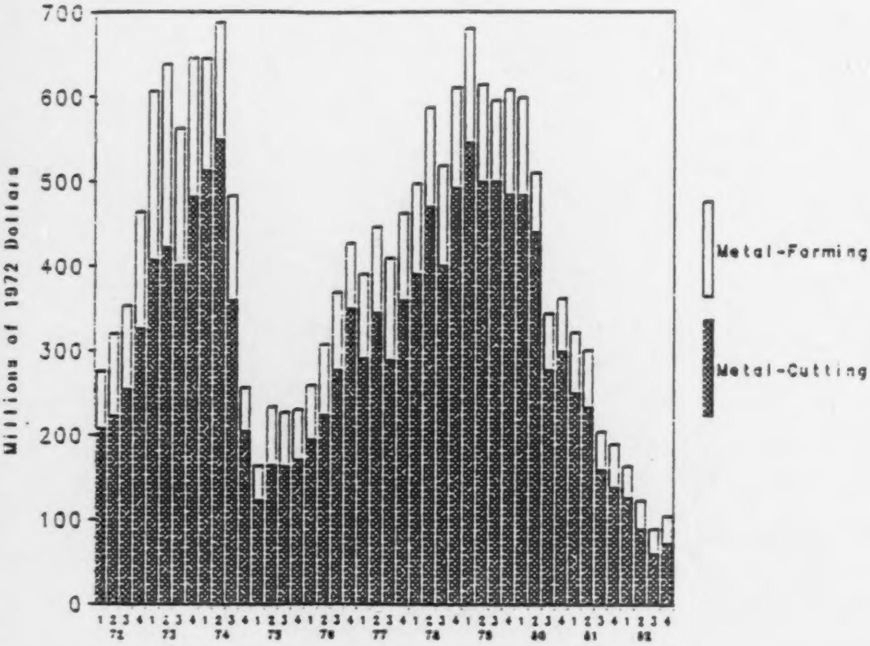
Domestic Consumption of Machine Tools
Under Recent History
1982-87

	Billions of 1972 Dollars 1977	1978	1979	1980	1981	1982	Annual Growth Rate 1977-1982
Aggregate Consumption of Machine Tools	2.196	2.717	3.265	3.358	3.362	2.819	5.122
Aggregate Consumption of Metal-Cutting Tools	1.630	2.084	2.530	2.716	2.827	2.354	7.625
Aggregate Consumption of Metal-Forming Tools	0.566	0.633	0.735	0.643	0.534	0.465	-3.842
Aggregate Defense-Related Consumption of Machine Tools	0.223	0.255	0.325	0.364	0.571	0.564	20.401
Direct	0.080	0.083	0.088	0.093	0.265	0.280	28.472
Indirect	0.027	0.028	0.036	0.037	0.051	0.046	10.775
Induced Capital	0.116	0.144	0.202	0.234	0.254	0.239	15.592
Defense-Related Consumption of Metal-Cutting Tools	0.177	0.205	0.262	0.302	0.489	0.486	22.468
Direct	0.066	0.068	0.072	0.077	0.231	0.242	29.739
Indirect	0.020	0.021	0.027	0.029	0.042	0.038	14.011
Induced Capital	0.091	0.116	0.163	0.196	0.217	0.206	17.789
Defense-Related Consumption of Metal-Forming Tools	0.046	0.050	0.063	0.062	0.081	0.078	10.881
Direct	0.014	0.015	0.015	0.016	0.035	0.038	21.754
Indirect	0.008	0.008	0.009	0.008	0.009	0.008	-0.033
Induced Capital	0.025	0.028	0.038	0.038	0.038	0.033	5.651

SOURCE: Data Resources, Inc., DEMIS and DIFS models (1983).

FIGURE 9

Net New Orders for Machine Tools
Received by U. S. Builders
(1972 Dollars)
Quarterly, 1972-82

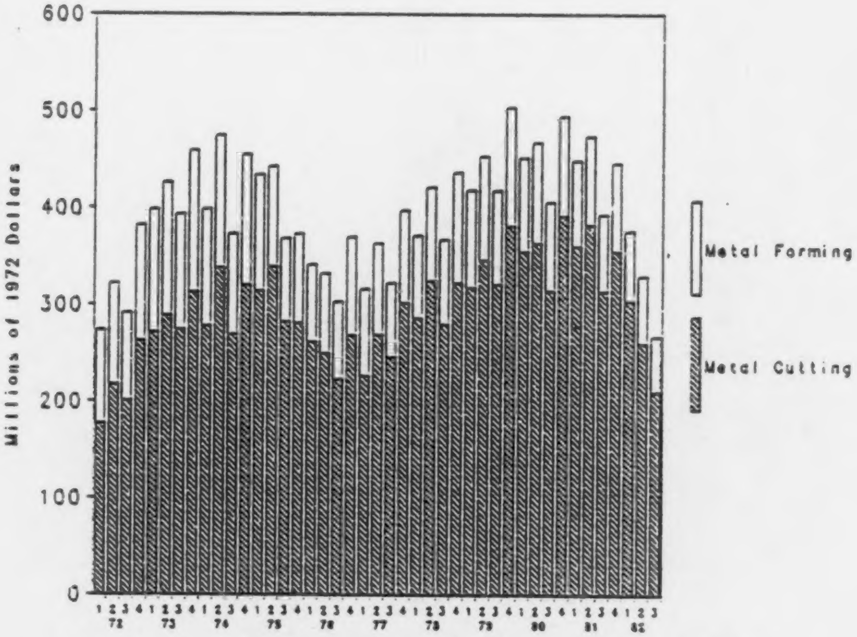


Source: NMTBA 'Economic Handbook of the Machine Tool Industry, 1982-83' and NMTBA 'Industry Estimate of Machine Tool New Orders, Cancellations, Shipments and Backlog' (monthly).

Adjusted using BLS Producer Price Index for respective sector, re-based to 1972=1.00.

FIGURE 10

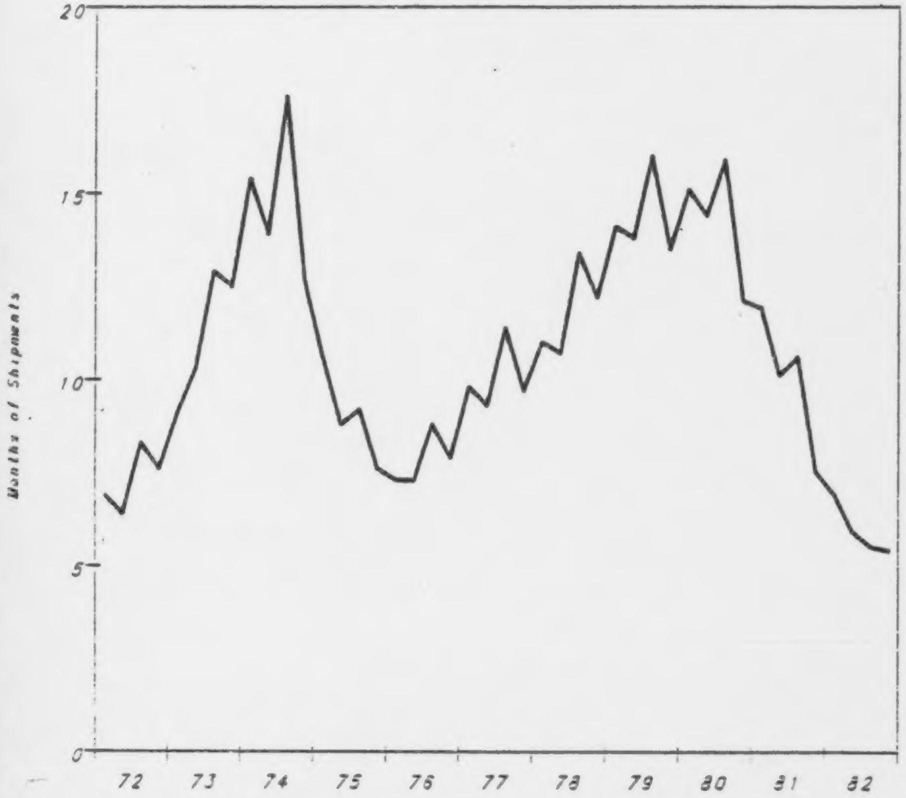
Shipments of Machine Tools
by U. S. Builders
(1972 Dollars)
Quarterly, 1972-82



Source: U. S. Department of Commerce, 'Current Industrial Reports, Series MQ-35W, Metalworking Machinery' (quarterly and annual summaries).

Adjusted using BLS Producer Price Index for respective sector, re-based to 1972=1.00.

FIGURE 11

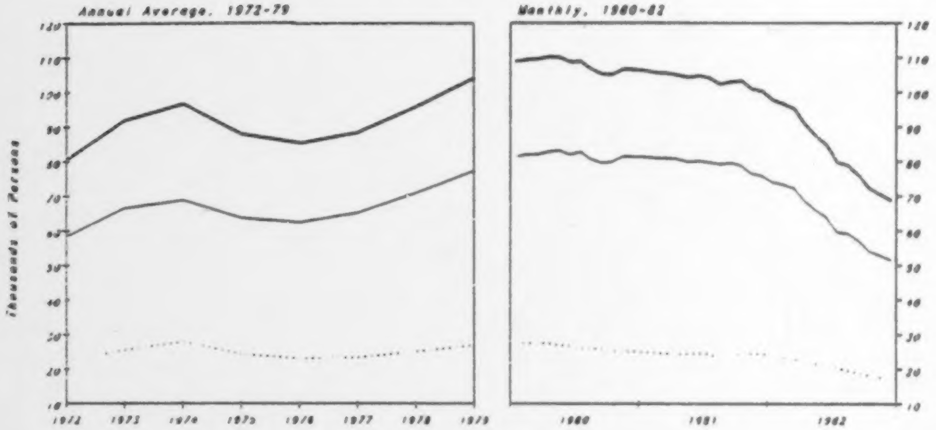


Backlog of Unfilled Orders
for U. S. Machine Tools
(in months of shipments)
Quarterly, 1972-82

Source: NMTBA 'Economic Handbook of the Machine Tool Industry, 1982-83' and NMTBA 'Industry Estimate of New Orders, Cancellations, Shipments and Backlog' (monthly)

FIGURE 12

Total Employment in the Machine Tool Industry (Thousands of Persons) 1972-82

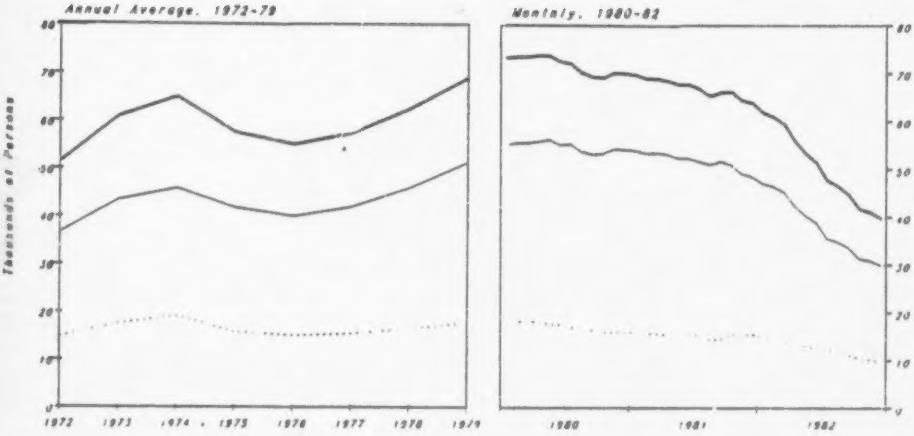


Metal-Cutting = Line
Metal-Forming = Dot
Industry Total = Bold Line

Source U. S. Department of Labor, Bureau of Labor Statistics, 'Employment and Earnings' (monthly)

FIGURE 13

Employment of Production Workers in the Machine Tool Industry (Thousands of Persons) 1972-82

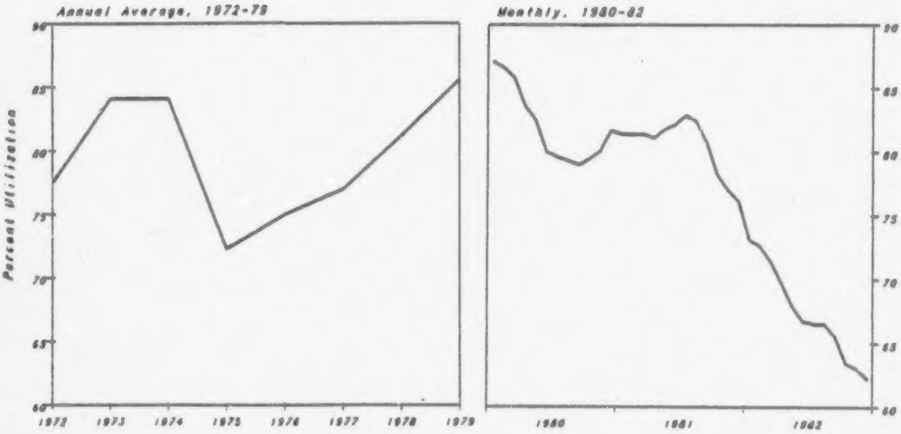


Metal-Cutting = Line
Metal-Forming = Dot
Industry Total = Bold Line

Source: U. S. Department of Labor, Bureau of Labor Statistics, "Employment and Earnings" (monthly)

FIGURE 14

Capacity Utilization
in the Nonelectrical Machinery Industry
1972-82

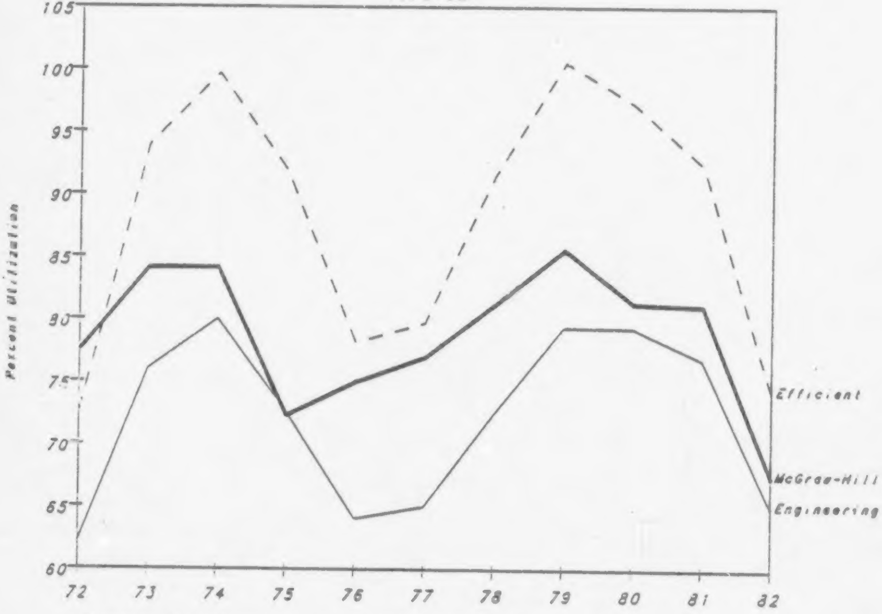


Source: McGraw-Hill Publications Company, Department of Economics, 'McGraw-Hill Operating Rates Report' (monthly).

FIGURE 15

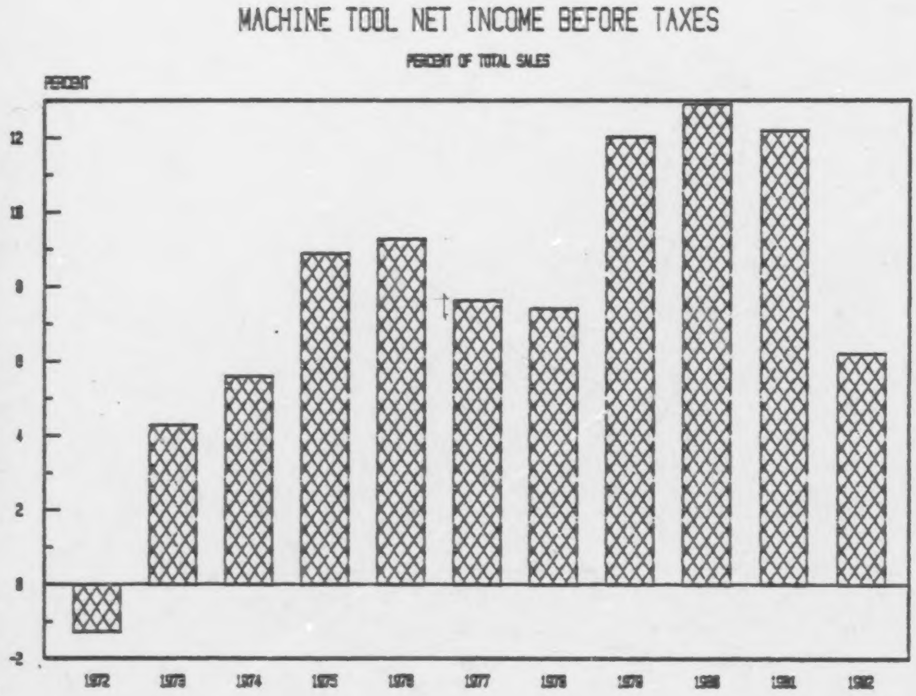
Capacity Utilization:

McGraw-Hill Rates for the
Non-electrical Machinery Industry and
DRI 'Efficient' and 'Engineering' Rates for the
Machine Tool Industry
1972-82



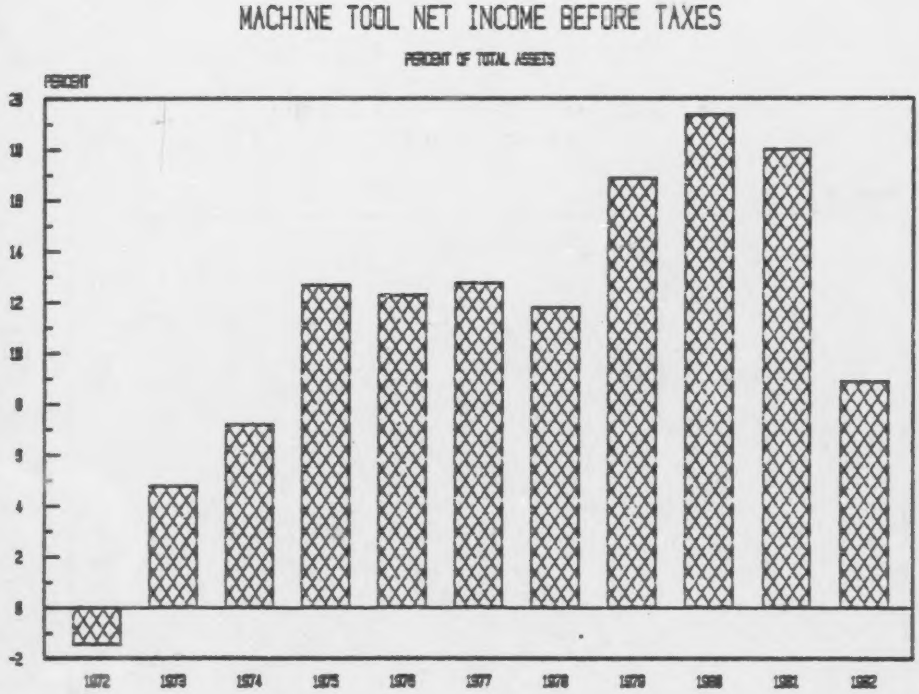
Source: Data Resources, Inc. (1983) and McGraw-Hill Publications Company, Department of Economics, 'McGraw-Hill Operating Rates Report' (monthly)

FIGURE 16



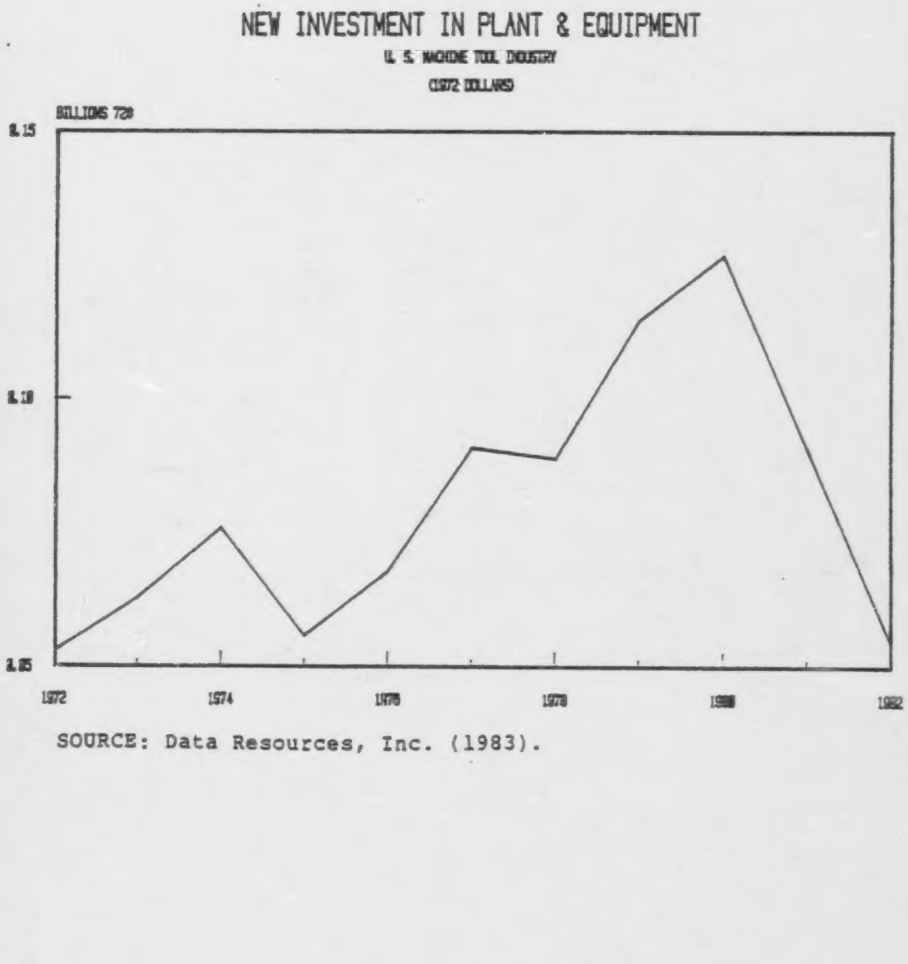
SOURCE: NMTBA "Economic Handbook of the Machine Tool Industry 1982-83," p. 255; 1982 projection by Data Resources, Inc. (1983).

FIGURE 17



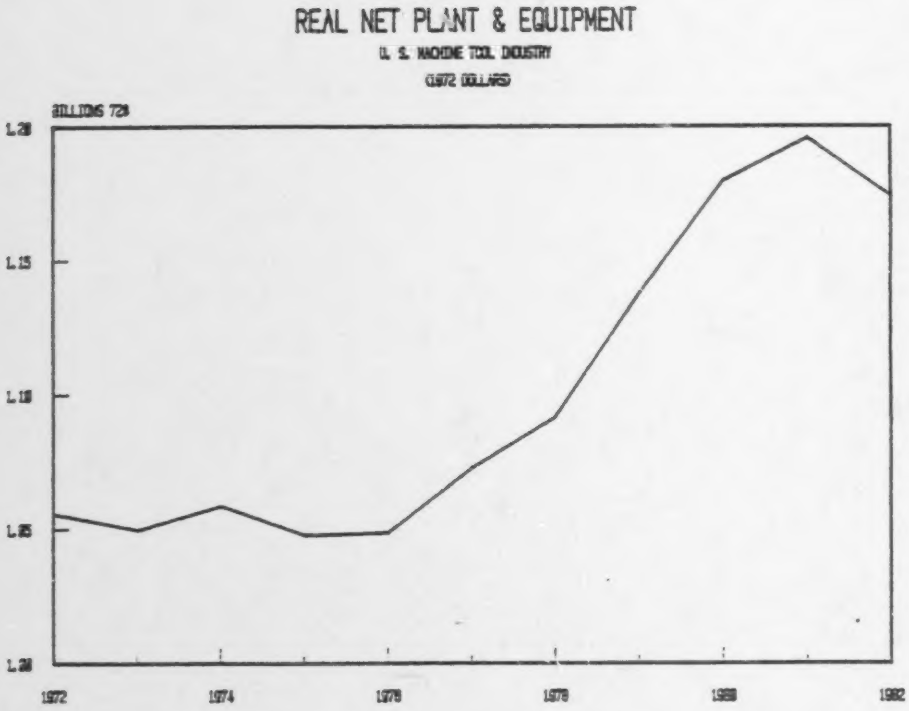
SOURCE: NMTBA "Economic Handbook of the Machine Tool Industry 1982-83," p. 255; 1982 projection by Data Resources, Inc. (1983).

FIGURE 18



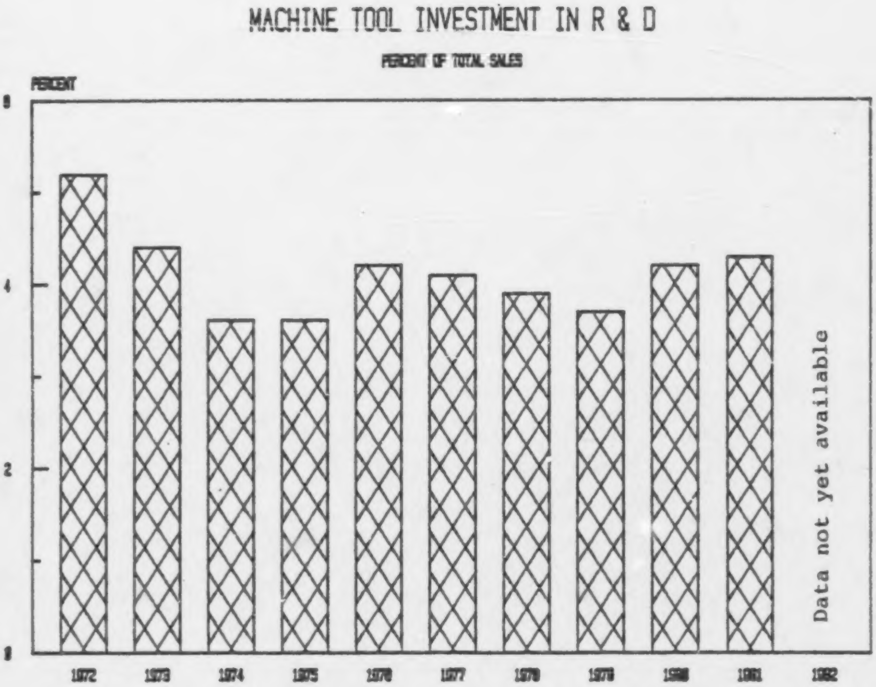
SOURCE: Data Resources, Inc. (1983).

FIGURE 19



SOURCE: Data Resources, Inc. (1983).

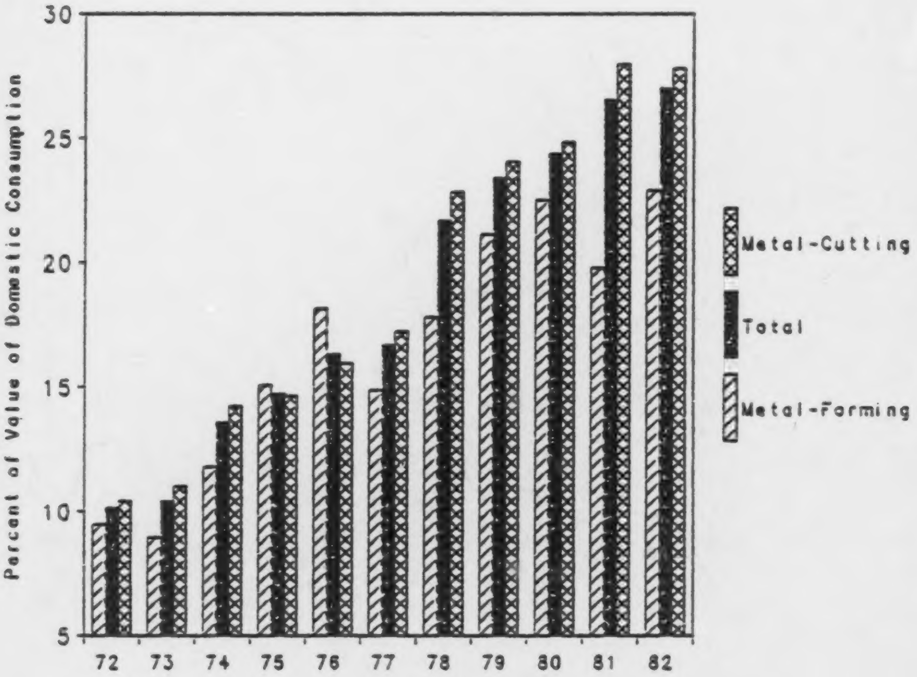
FIGURE 20



SOURCE: National Machine Tool Builders' Association, "Confidential Financial & Operating Ratio Report."

FIGURE 21

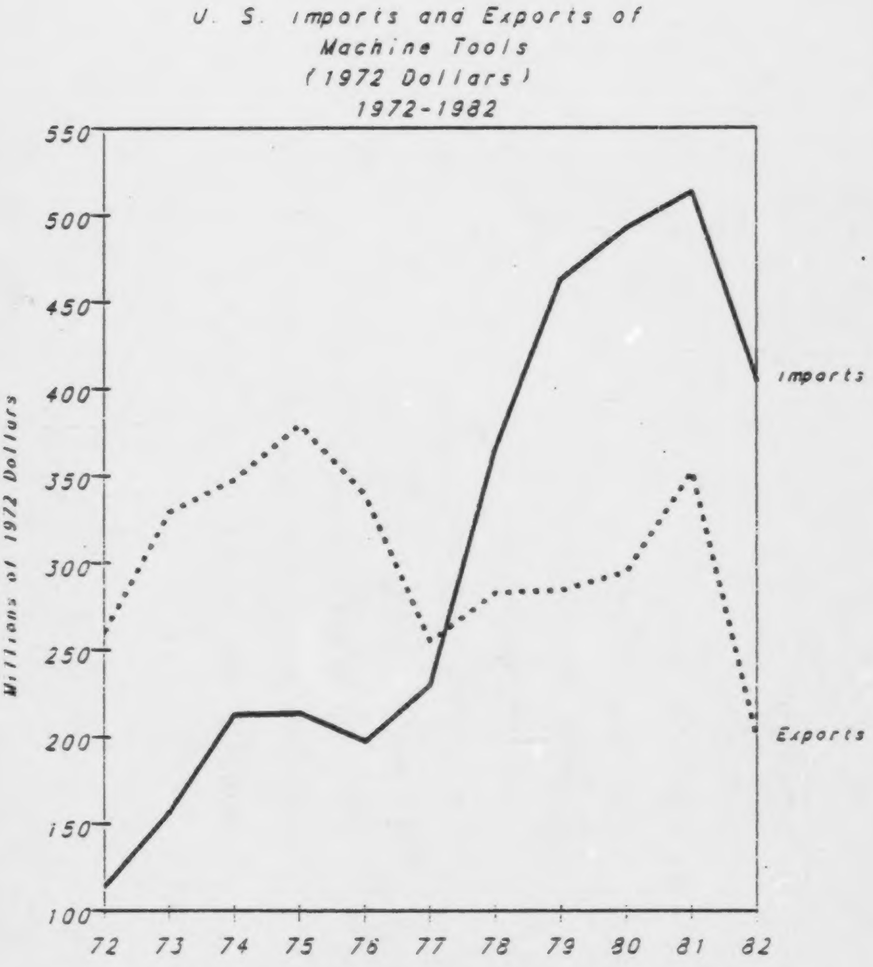
Import Share of
Value of U. S. Domestic Consumption of
Machine Tools
1972-82



Source: U. S. Department of Commerce, Series IM-146 and EM-522 (monthly), and 'Current Industrial Reports', Series MQ-35W, Metalworking Machinery (quarterly and annual summaries).

1982 data are for first three quarters.

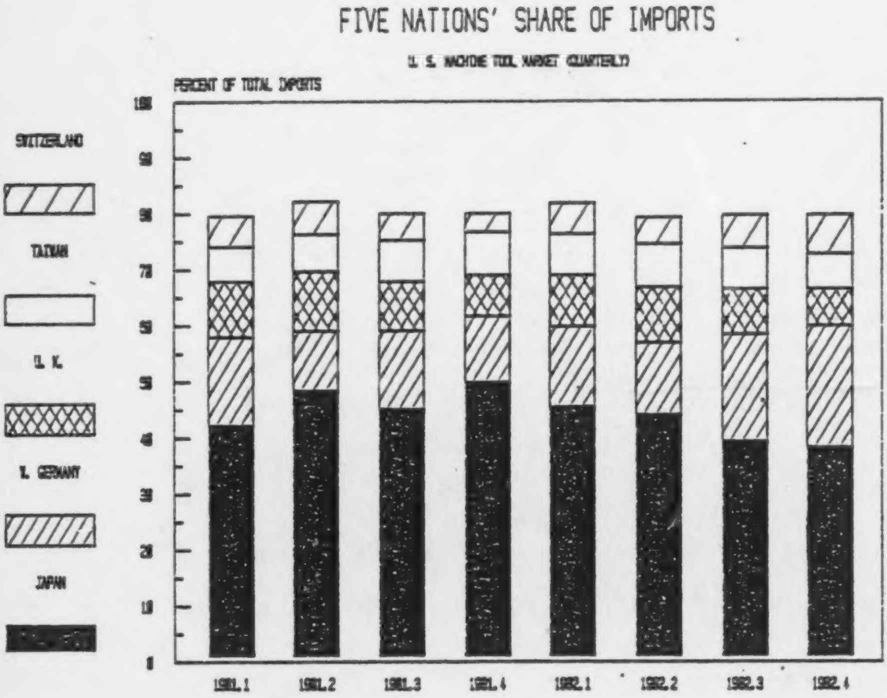
FIGURE 22



Source: U. S. Department of Commerce, Series IM-146 and EM-522 (monthly)

Adjusted using BLS Producer Price Index for respective sector, re-based to 1972=1.00

FIGURE 23



SOURCE: U.S. Department of Commerce, Import Report IM146, (monthly).

FIGURE 24

Machine Tool Industry Investment Behavior Simulation
(Billions of 1972 Dollars)

				Annual Production Capacity[1]	
	Output*	New Investment	Net Plant & Equipment (year-end)	Efficient	Engineering
1982					
With Imports	$2.417	$0.055	$1.174	$3.258	$3.721
Without Imports	$3.163	$0.085	$1.205	$3.334	$4.041
Percentage Change Without Imports	31%	55%	3%	2%	9%
1983					
With Imports	$2.468	$0.056	$1.159	$3.254	$3.767
Without Imports	$3.259	$0.084	$1.212	$3.394	$4.142
Percentage Change Without Imports	32%	50%	5%	4%	10%

Source: Data Resources, Inc., (1983).

*Industry output includes production to satisfy both domestic and export demand for U.S.-built machine tools.

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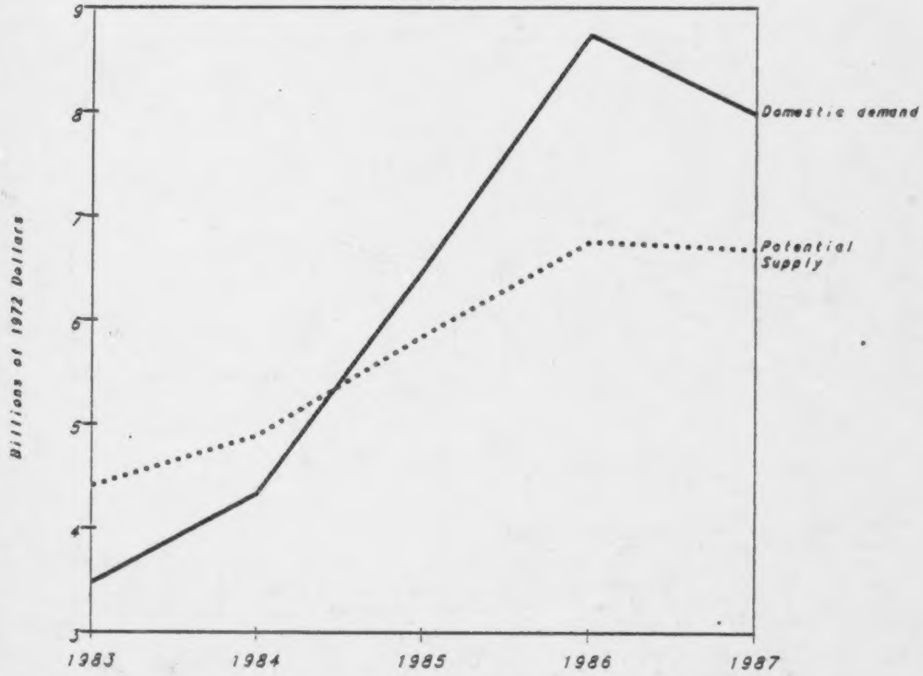
[1] The two definitions of capacity are discussed at pages 118 - 21 supra.

FIGURE 25

U. S. Demand (a) for Machine Tools
and Potential Supply (b) of Machine Tools
Under the 'Large Conventional War' Scenario
(1972 Dollars)
1983-87



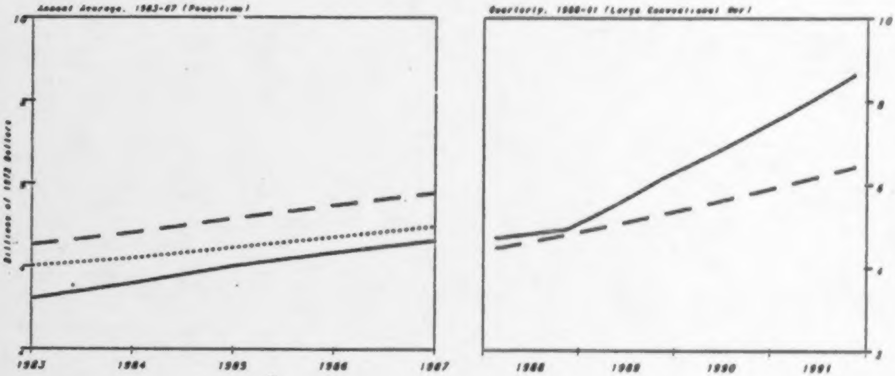
Source: Data Resources, Inc. (1983).

(a) U. S. demand is defined as domestic demand with no exports

(b) Potential supply is defined as the maximum output of the domestic machine tool industry under emergency operating conditions, with no imports.

FIGURE 26

U. S. Demand for Machine Tools
and Potential Supply of Machine Tools
Absent Section 232 Remedy (1983-87)
And the 'Large Conventional War' Scenario (1988-91)
(1972 Dollars)



Source: Data Resources, Inc. (1983).

Demand (a) = Line
Potential Efficient Supply (b) = Dot
Potential Engineering Supply (c) = Dash

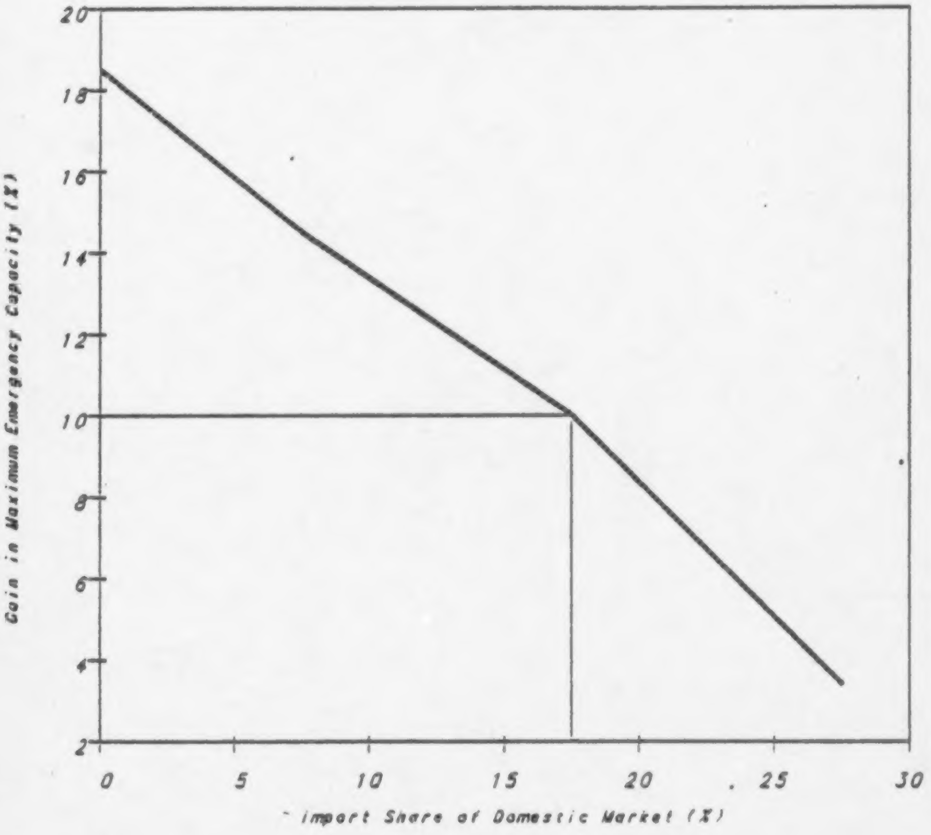
(a) U.S. demand is defined as domestic demand plus exports for the period 1983-1987 and as domestic demand with no exports for the period 1988-1991.

(b) Potential effici[illegible]upply is defined, for the period 1983-1987, as the maximum ou[illegible] the domestic machine tool industry under normal op[illegible]nditions, plus projected imports absent Section 232 rem[illegible]

(c) Potential eng[illegible]erin[illegible] is defined, for the period 1983-1987, as [illegible]e ma[illegible]put of the domestic machine tool industry unde[illegible]mer[illegible]ating conditions, plus projected imports absent Se[illegible]dy; and, for the period 1988-1991, as the [illegible] of the domestic industry under emergency operati[illegible], with no imports.

FIGURE 27

'Trade-off' Between Gain in
Maximum Emergency Capacity (a) and
Levels of Import Remedy (b)

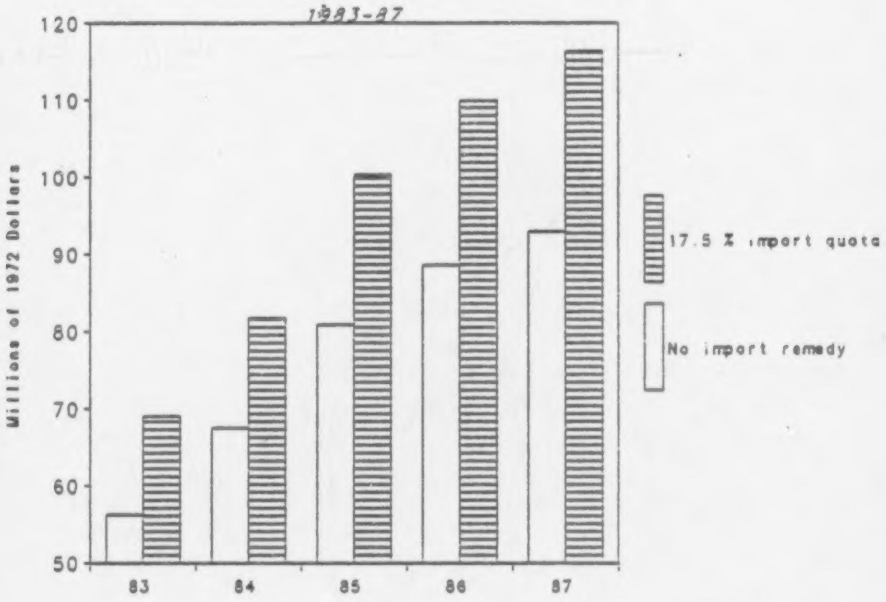


Source: Data Resources, Inc. (1983).

(a) Percent increase in maximum emergency capacity in 1987 over the amount otherwise available absent Section 232 remedy.

(b) Import quota established as Section 232 remedy.

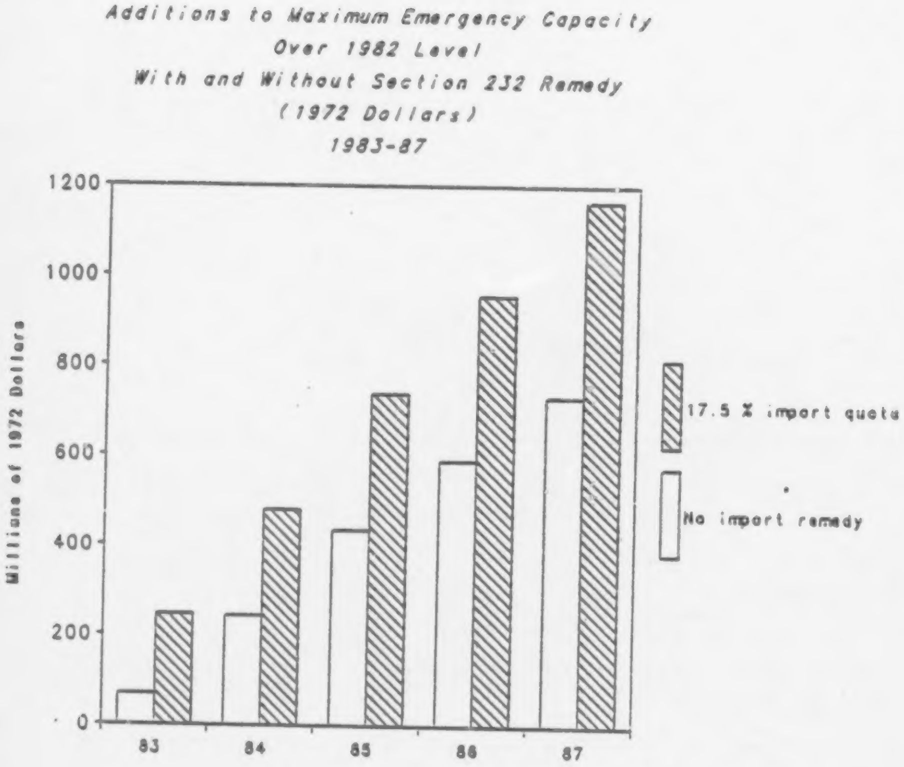
FIGURE 28



Annual Net Investment in
Plant and Equipment
in the Machine Tool Industry
With and Without Section 232 Remedy
(1972 Dollars)
1983-87

Source: Data Resources, Inc. (1983).

FIGURE 29

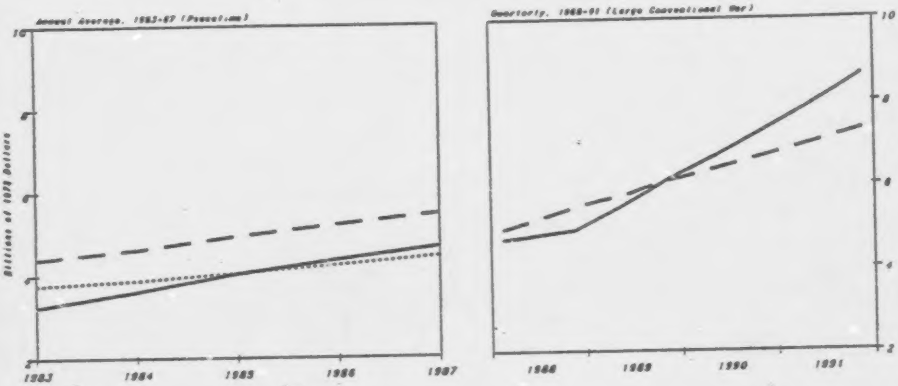


Additions to Maximum Emergency Capacity
Over 1982 Level
With and Without Section 232 Remedy
(1972 Dollars)
1983-87

Source: Data Resources, Inc. (1983).

FIGURE 30

U. S. Demand for Machine Tools and Potential Supply of Machine Tools With Section 232 Remedy (1983-87) And the 'Large Conventional War' Scenario (1988-91) (1972 Dollars)



Source: Data Resources, Inc. (1983).

Demand (a) = Line
Potential Efficient Supply (b) = Dot
Potential Engineering Supply (c) = Dash

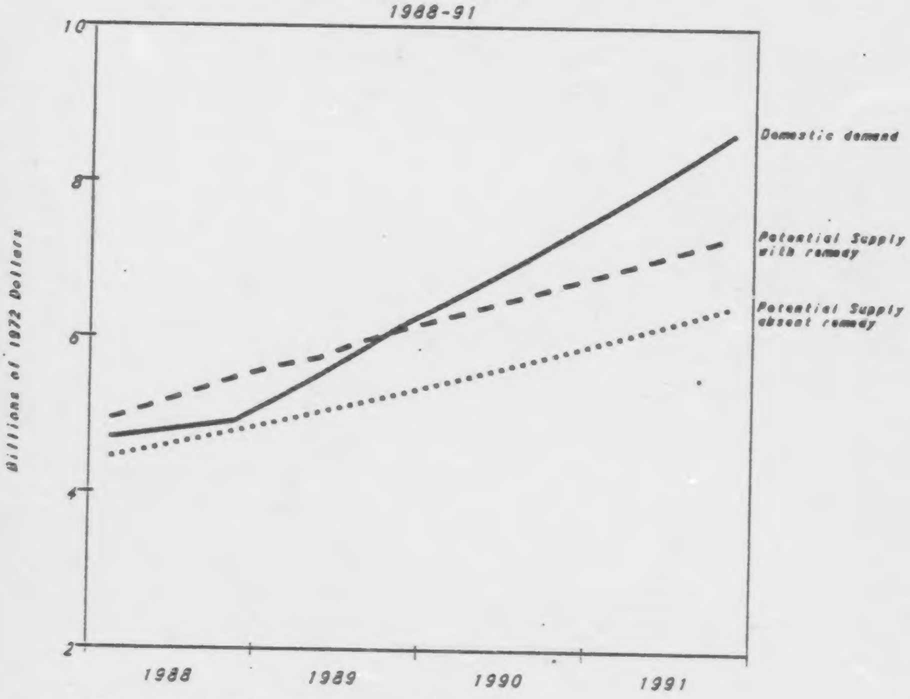
(a) U.S. demand is defined as domestic demand plus exports for the period 1983-1987 and as domestic demand with no exports for the period 1988-1991.

(b) Potential efficient supply is defined, for the period 1983-1987, as the maximum output of the domestic machine tool industry under normal operating conditions, plus projected imports with Section 232 remedy.

(c) Potential engineering supply is defined, for the period 1983-1987, as the maximum output of the domestic machine tool industry under emergency operating conditions, plus projected imports with Section 232 remedy; and, for the period 1988-1991, as the maximum output of the domestic industry under emergency operating conditions, with no imports.

FIGURE 31

U. S. Demand (b) for Machine Tools
and Potential Supply (b) of Machine Tools
Under the 'Large Conventional War' Scenario
(1972 Dollars)
1988-91



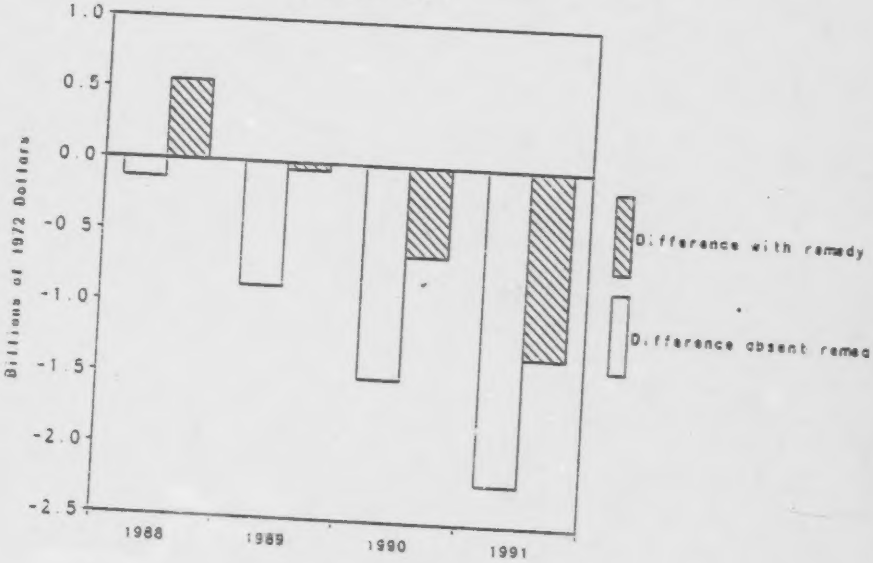
Source: Data Resources, Inc. (1983)

(a) U. S. demand is defined as domestic demand with no exports

(b) Potential supply with and without Section 232 remedy is defined as the maximum output of the domestic machine tool industry under emergency operating conditions, with no imports.

FIGURE 32

Difference Between Maximum Emergency Capacity (a)
With and Without Section 232 Remedy (1983-87)
and Demand (b) for Machine Tools
Under the 'Large Conventional War' Scenario (1988-91)
(1972 Dollars)



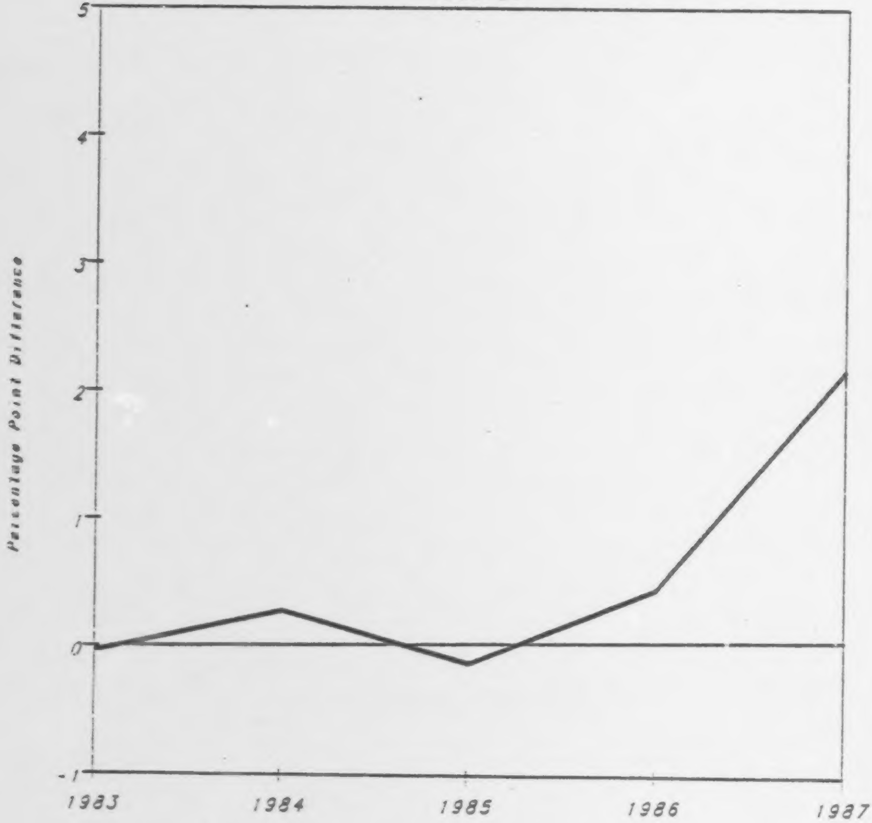
Source: Data Resources, Inc. (1983).

(a) Maximum emergency capacity in each case is defined as the maximum output of domestic machine tool industry under emergency operating conditions, with no imports

(b) U.S. demand is defined as domestic demand with no exports

FIGURE 33

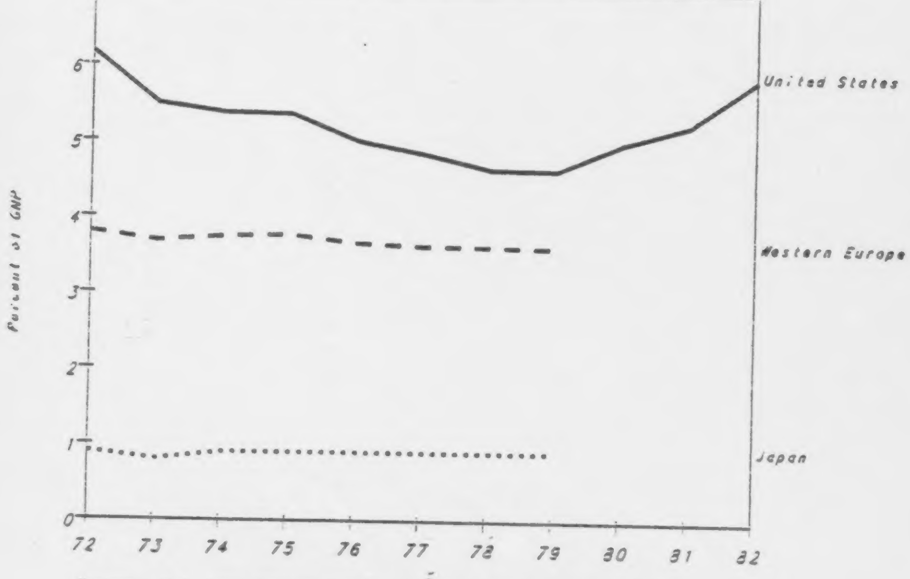
Difference in Annual Rate of Change
of Composite Producer Price Index for Machine Tools
With and Without Section 232 Remedy
1983-87



Source Data Resources, Inc. Cost Forecasting Service (1983)

FIGURE 34

Defense Spending as a
Percent of Gross National Product,
Western Europe, Japan and the United States
1972-82



Source: U.S. Arms Control and Disarmament Agency, 'World Military Expenditures and Arms Transfers' (1983), and U.S. Department of Commerce, Bureau of Economic Analysis, 'National Income and Product Accounts of the United States'.

'Western Europe' includes the United Kingdom, France, Italy and West Germany.

(Post-1979 data for Western Europe and Japan not yet reported).

Chairman GIBBONS. Yes, sir. I was listening to your plea for national security, 232 relief. Let me read you some of Mr. Lamb's testimony about the United States-Japan relationship. It says:

> The United States-Japan relationship is a keystone for peace and prosperity in the Pacific region. Japan is our principal ally in Asia, and serves not only as an outpost for U.S. forces, but as a basic contributor to the defense of the region itself. At the urging of the United States, Japan has recently assumed greater responsibility for defense in the northern Pacific, and Prime Minister Nakasone has committed Japan to increase defense spending and strengthen its defense forces. Furthermore, Japan is a major donor of economic assistance to the region:
>
> The intensity of the economic relations between the United States and Japan has often been pointed out.

And it goes on. Well, on a 232 petition, where do you think they are going to come down on national security?

Mr. HOWE. Where are the Japanese going to come down?

Chairman GIBBONS. No, where is the U.S. Government going to come down? With the State Department pointing out all those things to the President and the President having made commitments to Japan and Japan having made commitments to us, I doubt that he is going to stop in a 232 case.

Mr. HOWE. Well, I think, Mr. Chairman, the real question is do the facts support the contention, as we believe they do, that there is a national security issue here. I suspect if that is established—and we certainly believe it is on the basis of the research and the study that we put together—that the administration would have no choice but to recognize it and take whatever measures are deemed necessary to reduce the importation of Japanese machine tools.

Chairman GIBBONS. In your statement, you said these were subsidized exports. Do you have any information that was not presented in the Houdaille case about subsidy or are you relying upon the Houdaille case for subsidy?

Mr. HOWE. We conducted our own investigation but we were aided from several sources in putting that study together. So I would say it is a combination of the best evidence that we could acquire.

Chairman GIBBONS. So all the evidence we have on being subsidized as far as you are concerned, comes from what is already displayed in the Houdaille case. Is that right?

Mr. HOWE. Well, I would not say that. About a year and a half ago, several of the members of our association visited Japan for the expressed purpose of gaining a deeper understanding as to what the Japanese did and how they did it.

Chairman GIBBONS. Yes?

Mr. HOWE. And the evidence that we collected clearly indicated that it was basically a Japan, Incorporated operation that was creating the kind of capability that we had. The testimony of the Japanese machine tool builders themselves.

Chairman GIBBONS. Maybe you are or aren't the best one in your association to answer this question:

Why didn't you try the subsidy route if you believe there have been subsidies? There is less Presidential discretion in the subsidy case than there is in——

Mr. HOWE. Well, I think I would answer it this way: We have agonized for some period of time over our plight and what was happening.

The machine tool industry is of a very cyclical nature. But what was different this time was the fact that there was this tremendous incursion of Japanese machine tools. The more we studied this situation, and the more we analyzed it, being machine tool builders and having been through defense requirements in the past two decades, we perhaps recognize more than anybody else what a tremendous burden mobilization puts upon machine tool builders when it occurs.

Historically, machine tool builders have been a bottleneck to the national defense in times of surge. With this continuing demise of our industry, we felt finally that this problem really had to be brought to the attention of the administration and the public.

It is a very serious problem.

Chairman GIBBONS. Do you understand how the Japanese maintain the large inventory of machine tools that apparently they do in our market and that we don't?

Mr. HOWE. Well, I can only relate that to Japan, Incorporated. Our opinion is that it is a question of national policy. The Japanese have been surprised by the collapse of the market for machine tools in the most recent year or so, but it has been the policy of Japan to target certain aspects of the machine tool industry particularly these numerically controlled machines that I spoke of—and do all the things that are necessary to provide the inventory to support the program.

That, I believe, it is fair to say, is their national policy.

Chairman GIBBONS. Do you know where they get the money from to maintain these huge inventories they are alleged to have?

Mr. HOWE. I can't honestly answer that one. I think I would relate that also it is being a national policy.

Mr. MACK. No American builder could afford to maintain that kind of inventory.

Chairman GIBBONS. That is what I am talking about. Do we have any evidence as to where the funds are coming from that would support that kind of inventory maintenance?

Mr. HOWE. I don't think we do.

Mr. MACK. You mentioned the Houdaille evidence. The documentation in the Houdaille case has been extraordinary.

Chairman GIBBONS. Yes, I agree.

Mr. MACK. And, by the way, apparently undisputed vis-a-vis the administration. Most of the facts were accepted when they made the decision to turn down the petition. I think that the evidence is instructive in determining where the Japanese are getting the money to support the kind of inventory that they are supporting in the United States and in Japan.

Chairman GIBBONS. Mr. Hance has asked me to ask you a question.

In order to compete in the world market, what do you need?

Mr. HOWE. Well, that is a favorite topic of ours. We, as an industry, would love to see an honest trade policy developed for this country. We believe we have fine products as do many other industries, but we are unable to compete realistically in world markets.

That is partially due to the strong dollar, but it is also due to the fact that, as a country, we have never put our act together and decided that export trade was all that significant, as it relates to many products which we built.

And we see the support that the Japanese have give to some of their machine tool builders in various countries, trading companies and financing programs—support which we can't equal.

Chairman GIBBONS. Would you want your Government to carry on industrial targeting as the Japanese Government carries it on?

Mr. HOWE. No. We don't believe in that. We look at it in terms of just being able to trade fairly with our competitors. We have competed, Mr. Chairman, with the European machine tool builders, many of whom are very, very capable and we competed on equal terms.

There have been certain cases of special treatment, but generally speaking, that is the kind of competition we are very comfortable with. But we cannot compete with Japan, Incorporated.

Chairman GIBBONS. We are going to put your entire statement in the record, because I realize you had to summarize it. And that is all the questions we have at this time.

Mr. HOWE. Thank you very much. I would just like to emphasize again, Mr. Chairman, if I may, that this national security concern is a real one. We think that it is absolutely essential that this country recognize how significant machine tools are in terms of everything that happens in our economy. If our industrial base starts to come apart because the machine tool industry can't support it properly, it is our feeling that we will be creating some very horrendous problems for ourselves in case of the possibility of a national security mobilization.

Mr. JONES. Mr. Chairman, I apologize for being late. I will read your testimony in its entirety, but did you pinpoint, in addition to unfair trade practices why the machine tool industry in the United States cannot compete? Is our labor out of line? Are our processes outdated or anything like that?

Mr. HOWE. Well, that is a very fair question, and we ask ourselves those questions every day. I would start off by answering you that the technology that we have as machine tool builders in this country is second to none.

The most sophisticated systems of machine tools in operation in this country were built, all of them, by American machine tool builders. So in terms of technology, we are very comfortable. We do have other problems as any industry does in this country, relative to Japan, Incorporated. We know that within Japanese companies, there is a unity of spirit and a complete willingness and dedication of everyone to work together. I think that is a problem for our entire society, but we industrialists have some more to do in that direction, too.

Mr. JONES. But, for example, the notion of an economic cooperation council is being talked about, particularly in our party, as a mechanism to bring business, labor, and Government together to target goals and how to achieve those goals, and who has to contribute what to achieving those goals.

Would that kind of mechanism enable us to compete more effectively?

Mr. HOWE. Well, I would have to answer that on a personal basis, rather than speak for my peers in the association. It seems to me that the more we do to try to build the cooperative spirit in this country to get our industry shaped up again, so we can compete worldwide, the better off we will be.

It also seems to me that, in the final analysis, if we are going to permanently solve our unemployment problems, it has to be on the basis of industrial products made on a competitive basis in this country, and shipped around the world.

That seems to be a very obvious avenue and many of the machine tool builders feel very strongly that way. I would also add that many of my peers are very active in developing the kind of cooperative spirit with unions and trying to recreate the industrial establishment so that we take the very best advantage of all of the human resources available to us to do the job better.

We acknowledge that those things need to be done. But having looked at all those things, and recognizing the part that we have to play, we still come back to this other very serious point that we cannot survive on the basis of this continuing impact of imported machine tools. When the business starts to pick up again—and it will—this great overhang of Japanese machine tools will be the first sold—and at acceptable prices, I am sure.

Consequently, the industry will become weaker and weaker. When you look at that in relationship to the possible surge requirement, that the defense people speak about, we think we have a jeopardized situation. That is our major concern, and that is where we are directing our thoughts.

Mr. MACK. I think that you also need to look at what it is you are competing against. In a normal competitive situation, the type of cooperative effort that you suggested, would enable us to compete very well. But if your competitor at the same time, is doing the same thing and is also receiving subsidies, and if this Government is limiting the people who can receive those subsidies by, in effect, carving up market share and countenancing the kind of activities which, if they were conducted in the United States, would lead to legal troubles; then, I think, some serious questions are raised as to whether you can be competitive—even with the type of arrangement you are talking.

Mr. JONES. My final question is, do you perceive that the wage rates in your industry are out of line with the Japanese to any great extent?

Mr. HOWE. They are out of line with the Japanese, but not to the degree that one finds in the automotive industry, as a general statement.

Mr. JONES. Thank you, Mr. Chairman.

Chairman GIBBONS. Thank you.

Mr. HOWE. Thank you very much.

Chairman GIBBONS. The American International Automobile Dealers Association, Mr. Thomas Nemet, who is the chairman; and Mr. Robert McElwaine, who is the president.

STATEMENT OF ROBERT M. McELWAINE, PRESIDENT, AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION, ACCOMPANIED BY BART FISHER, COUNSEL

Mr. McElwaine. Thank you, Mr. Chairman. Mr. Nemet cannot be with us today. He is attending the opening of the Honda plant.

I have with me, however, my accomplice, Dr. Bart Fisher of Georgetown University and Patton, Boggs & Blow.

I certainly appreciate you and Congressman Jones sticking with us through this long day of hearings, as you understand.

Chairman Gibbons. We appreciate your sticking with us, too. We recognize that the witnesses have a tougher time than we do, although those chairs look about as uncomfortable as ours.

Mr. McElwaine. Ambassador Mike Mansfield, who has been right about almost everything else over the last 30 years, recently characterized the United States-Japan relationship as the most important bilateral relationship in the world, and I think he is probably right again on that.

But what is unfortunate about that relationship is that our present dialog with Japan more nearly resembles the haggling over a used car sale than it does the relationship of two of the great industrial powers of the world with mutual dependencies and global responsibilities.

In the past year, the subjects which have occupied the attention of some of our leading administrative officers and the front pages of newspapers both here and in Tokyo, have included such things as the Japanese Little League standards for baseball bats and the number of U.S.-made cigarettes permitted in vending machines.

Columnist Joseph Kraft pointed out that embitterment is the inevitable consequence of these constant shoot-outs over increasingly low-level issues.

Kraft blames it on the failure of the United States to develop a coherent economic strategy, and I think he might have added a second failure, which is the failure to relate fiscal and monetary policies with our overall global concerns.

Absent any kind of explicit Government strategy, contending private interests have really become the chief authors of U.S. economic and trade policies toward Japan. American interests subject to competition from Japanese firms have sought and in most cases received Government help in their commercial rivalry.

Over a span of several administrations, a pattern gradually developed in these disputes. At times, the American industries would follow established procedures and go to the International Trade Commission; they would file a complaint under the escape clause or a dumping charge or a countervailing duty subsidy charge, and if the ITC then did not find in their favor, they would turn to the Congress and to the administration for relief.

At other times, they simply ignored the ITC and went straight to the Congress or straight to the administration.

Then, against a mounting threat of legislative action, the administration would negotiate an agreement with the Japanese that would provide the aggrieved U.S. industry with some kind of shelter.

Thus, textile restraints were negotiated under John Kennedy, television sets under Lyndon Johnson, additional textile restraints under Richard Nixon, steel under Jimmy Carter, and automobiles under Ronald Reagan.

Consequently, the process of trade negotiation has become increasingly politicized, contributing to the stridency of the debate and the deepening of the resentment that really exists on both sides of this particular situation.

I think the greatest obstacle to any kind of rational analysis of United States-Japan bilateral trade relations—and I mentioned this in our hearing last week, Mr. Chairman—is the difficulty in separating myth from reality. The concept that the U.S. market is free and open to Japanese goods while theirs is closed to our exports, has become generally accepted, so much a part of the popular wisdom today that when we come before this committee or Mr. Florio's committee or any other committee, and deny its validity, we have the feeling that we are coming before a group of geographers and telling them that the world is really flat and they have been wrong all this time.

We have talked a great deal this morning about the Houdaille case, for example. Now, a basic premise of the Houdaille complaint was that the Japanese Government was subsidizing the machine tool industry in their country to the extent of $100 million a year in receipts from bicycle races.

This accusation is repeated in this morning's Washington Post, in the story that the President had rejected the appeal. However, more than a week ago, the Japanese Government, through their Minister here in Washington, announced that they had done an investigation into the charge, and that the subsidy was not $100 million, nor $1 million, but $280,000, and that was the total amount that they spent to advertise an industrial trade show in Tokyo of Japanese machine tool equipment.

And that is their estimate as to the entire extent of the subsidy coming from bicycle races: An advertising campaign to draw customers into a trade show in Tokyo.

You spoke earlier, Mr. Chairman, about the black and white nature of the complaints and the defense of the various accusations against the Japanese because of their trade practices.

We find this, too. It resembles more and more the old story of the five blind men trying to describe an elephant. Is it a $100 million subsidy or 280,000 dollars' worth of advertising for a trade show?

Mr. JONES. I think the chairman was referring specifically to the NTT.

Chairman GIBBONS. You are correct. If the Houdaille case only involved that much subsidy, why did it take us so many years to dispose of it? That is what puzzles me. You still have a black and white type of approach. Either the Japanese are wrong in their subsidy figure, or we are way wrong in our subsidy figure, and I don't know why we can't get to the bottom of these matters.

Mr. MCELWAINE. I think one of the problems, Mr. Chairman, may be that it is customary in these trade negotiations for the administration to unleash a softening-up barrage before the negotiations take place, in order to pressure the Japanese into taking some kind of meaningful action.

Unfortunately, these pronouncements tend to be taken at face value by the American media and then they enter into the folklore which now surrounds United States-Japan relations.

Also, the administration negotiators, in order to maintain their strong negotiating position, are obviously not in a position to come before this committee or talk to the press and say, "Well, you know the Japanese have really been pretty accommodating and they have made a lot of changes and we are making a lot of progress with them," which would only make their next negotiations a heck of a lot more difficult for them.

Obviously, the 7,000 American businessmen and the 165,000 American workers who depend on the sale and service of imported automobiles in this country are seriously threatened by this lack of understanding, and this kind of lack of comprehension of the true state of United States-Japan trade relations and from that standpoint, we certainly thank this committee for holding these hearings and for shedding more light on the entire situation concerning United States-Japan trade.

I think we must understand accurately the truth about United States-Japan trade relations because, unless we can clear up these miscomprehensions that exist today, the emotional reaction to all of these stories that we hear, the anecdotal history and the complaints about Japanese chicanery in trade are going to lead to increasing pressure on the Congress, if it is possible to have any greater pressure than you already have to take actions that might lead to the breakdown of our whole world trading system, and the collapse of our own economy.

What are the realities of this? Is there any way to distinguish between the black and white and simply come up with the gray facts? Is it true that the United States offers Japan unrestricted access to our markets while theirs is closed to us?

Well, we have to depend a great deal on economists. We have to depend on people like William Klein, who wrote for the Institute of International Economics and he said, "The widespread perception that the U.S. market is substantially more open than foreign markets has little empirical support."

Now, it is true that we are suffering a substantial trade deficit with Japan, $16.8 billion, I believe, this year. But, according to the United States-Japan study group, if you consider all goods and services, including the so-called invisible trade and long-term capital accounts, the actual balance of accounts between the United States and Japan is in the U.S. favor.

I think the official figures bear this out. Japan has become a leading net exporter of capital. In the first 7 months of the present fiscal year, Japan recorded a deficit of $12 billion in its long-term capital account. The current Japanese payments balance remains in deficit, despite the merchandise trade surplus that the country does enjoy.

There is no question, either, that Japan has endeavored to protect some of its industries and a lot of its weak agricultural sectors with a variety of trade barriers, but so has the United States, and so do most of the other nations of the world.

We are all sinners as Ambassador Brock said before this committee, in this particular way. But it remains true that if Japan were to eliminate every barrier it has to imports, tariff, nontariff, and all the rest, the consequences would reduce the U.S. deficit by less than 5 percent.

The U.S. deficit with Japan is, therefore, structural, to use a much-abused word again, and it is not likely to be balanced by any tinkering with duties, quotas, inspection systems and standards, and redtape.

You can't deny in any part of our economy today that the Japanese have been extremely accommodating over the last several years in easing and removing the barriers to the importation of American goods.

They responded to administration pressure by placing quotas on their own automobile exports and in dismantling some of the more onerous strictures previously placed on U.S. exports.

Of course, we don't have to deal with any complaint any more frequently than we do the one about the Japanese manipulation of the yen. The Japanese are somehow mysteriously manipulating the value of the yen so as to make their exports cheaper and imports more expensive.

But I think almost all economists today have come to agree that the disequilibrium today is due to an overvalued dollar, which is bloated by record high-interest rates. If any proof was needed, it was during that November to February period that we just went through, when our interest rates declined so sharply from 17 percent down to 10 percent during which time the value of the yen increased by about 15 percent against the dollar.

It went from 278 yen per dollar, all the way down to 228 before it bounced back up to the present 236 to 237 that it is at right now. Any arguments as to the reason for the disequilibrium between the yen and the dollar should have been answered by that particular trend.

There is also the fact that concurrent with the 1980 to 1982 increase in U.S. interest rates, the dollar appreciated by 40 percent against the pound, 55 percent against the French franc, 28 percent against the mark, and 27 percent against the yen, which brings out the fact that if the Japanese are, indeed, manipulating the yen, they also seem to be successful in manipulating all the other currencies of the world, which is an incredible accomplishment, I must admit.

Another economist, Robert Samuelson, who makes more sense than most economists I read, and he even comes to a conclusion occasionally, recently pointed out that in 1980, a German manufacturer's labor costs exceeded American labor costs by 24 percent.

By 1982, the dollar had pushed U.S. costs 12 percent above the German. There was no change in the relative wage being paid. It is just the fluctuation in the currency which made our labor go from being 24 percent cheaper than theirs to 12 percent more expensive.

The same thing has happened with the Japanese, going in the same direction. Right now, we say that, if the Japanese only pay automobile workers $12 an hour, and ours are getting $21 an hour, how can we compete? If you have got 180 yen to the dollar, that Japanese wage is going to be $17 or $18 an hour, and that is not slave wages. That is about twice as much as the average industrial wage in America.

It is a matter of changing the yardstick that has to be done here. There is also the fact, of course, that Japan dropped $8 billion in a 16-week period last year trying in vain to prop up the value of the yen. You have testimony, I hear, just last week, I believe, by the Under Secretary of the Treasury who gave you his own opinion that the Japanese were essentially interested in propping up the value of the yen. The situation in which they have to pay for their oil in dollars was creating a terrible situation for them in terms of their oil costs.

I think the link between our trade conflicts and the yen-dollar relationship is something that everybody has to study and understand. We have had three major trade disputes with the Japanese over the last decade. We had 1970–71, 1976–77, and 1981–82, and all you gentlemen were partners to all of those disputes and they all came at a time when the dollar was disproportionately valued against the yen.

If, as so many people have charged here before this committee, our trade deficit with Japan is due to protectionism in that country, then it would be a constant. There would be no discontinuity in that particular imbalance because protectionism is a continuous process and goes on all the time.

But in an era of floating rates, the dollar-yen relationship is in a state of constant flux, and all the available evidence that we have indicates that the exchange rate is the principal reason for the present imbalance in United States-Japan trade.

I think we can look forward, too, to a distinct change in that relationship soon. I think it is possible to anticipate a 200-yen-to-the-dollar ratio within the coming year.

As the interest rates in the two countries come more and more into balance, as we get out of double-digit interest rates in this country, which I hope we will do, this will reduce the flight of yen into dollars, eliminating the chief cause of the imbalance.

The increase in the value of yen also reduces Japan's oil cost, since all the oil prices are in dollar terms and this correction in the yen-dollar relationship then is going to have a synergistic effect on the value of the yen. And certainly the anticipated reduction in OPEC oil prices is going to strengthen the yen over the next several months.

There is going to be the usual lag in indicators that take place whenever you have an adjustment in currency like that, but I think by next year we should see a distinct change in our balance of payments with Japan.

We come to the final charge which is that of unequal market access. I think we should just have a balanced, objective look at this question of unequal market access without all the frequently trivial complaints about overly strict enforcement of standards and inspections and anecdotal history of problems that individuals and individual companies have had.

I think an overall view of the accessability of the two nation's markets would show that we enjoy roughly comparable access. The average Japanese tariff is lower than that of the average U.S. tariff and that of the Common Market as well. And by voluntarily accelerating its scheduled tariff reductions, Japan has increased that disparity. There have been recent cuts in the tariffs on politically sensitive items, as you know, including cigarettes and chocolate and biscuits. Incidentally, the increase in the tax on cigarettes has not changed the difference in the price between domestic and American cigarettes in Japan and the cut in tariff has not been affected by that.

But in the area of nontariff barriers, where Japan is usually the butt of accusations of unfair practices, the United States actually seems to be far more vulnerable to such charges. Major overt nontariff barriers are applied to 34 percent of the market for U.S. manufactures and only 7 percent of Japan's market for manufacturers.

Our U.S. nontariff barriers include restrictions on automobiles, textiles, apparel, foodware, television sets, steel, and in addition, we have many State barriers to imports. We have State "Buy American" laws. We have State agricultural restraints.

How many people know, for example, that 44 States prohibit the entry of Japanese mandarin oranges? We complain about the block to our citrus exports to Japan, but we have 44 out of 50 States that won't even let the Japanese oranges come in.

And when it comes to specific sectors or products there are an awful lot of examples that would belie these claims of a closed market in Japan. Coca-Cola is the largest selling soft drink in that country. You have been to Tokyo and you know that the McDonald's golden arches are all over the town. Schick razor blades shave 70 percent of all Japanese men's chins. In the field of high technology, IBM and Sperry jointly hold a 56-percent share of the Japanese market for large capacity computers. Nestle's has a 70-percent share of Japan's booming instant coffee market and, of course, American aircraft account for 90 percent of all the aircraft in Japan. Japan's inefficient agriculture industry and the barriers the government has erected to protect this politically potent block have long been a sore point in United States-Japan relations, and if you simply listen to the charges it is virtually impossible for Americans to export beef or citrus and tobacco products to Japan.

The facts don't bear that out. We sell more beef to Japan than we do to all the rest of the world combined. Sixty percent of all the beef the United States exports goes to Japan. The Japanese restrict beef imports to 32 percent of their market.

The United States restricts beef imports to 8 percent of its market.

We sell 40 percent of all the citrus we export to Japan. We provide more than 50 percent of Japanese tobacco. Now with tobacco, yes, the Japanese have figured out a couple of ways to hold the manufacture of the tobacco with Japanese firms and some of those things are a little sneaky. But the American farmer doesn't care whether he sells his tobacco to the Japanese tobacco cartel or R. J. Reynolds. He is getting the same price for it no matter where he sells it. It doesn't affect the farmer. It does affect the cigarette manufacturer, and there are some restrictions on that.

We hear a lot about Japanese protected agriculture but very little about American restrictions on agricultural imports. Sometimes our agricultural restraints are more stringent than the Japanese. We have quotas on sugar, dairy products, wheat, peanuts, cotton, as well as beef.

Nowhere is this xenophobic attitude toward Japan more ferocious than in the automobile industry. Detroit manufacturers have propagated successfully an illusion that they operate in a state of mutual antagonism with their own Government while the Japanese manufacturers and Government have conspired together to destroy the American industry. Any realistic look at the situation shows that the American industry is far more protected than the Japanese industry.

We have the highest tariff on trucks of any industrial nation in the world. We have a 25-percent duty on trucks. Even on the cheapest truck that is imported that amounts to about an $800 or $900 tariff the customer is paying to buy that car.

We have a discriminatory tariff on automobiles which charges everybody 2.8 percent duty except the American manufacturers bringing their product in from Canada. That total comes to about $178 billion a year in lost tariff revenues from Canadian imports, which has to be regarded as a subsidy for the American industry.

We have quotas on automobiles coming from Japan. We have had them in effect since 1981. They will be in effect at least until 1984. The industry has been the beneficiary of Government guaranteed loans up to $2½ billion, changes in the corporate income tax structure that have reduced their corporate tax liability down to virtually zero and other benefits from the administration, as well, in terms of regulatory easing in many fields.

There are also accusations of an uneven application of our standards to domestic cars as opposed to imported cars. Would it have taken 2 years to have come to the conclusion about brake failures on an imported car for a recall? Or would an imported car that kept backing up when it was supposed to be in "park" have gotten away with it by sending a sticker to the consumer to put on their windshields? I doubt it very much.

A lot of other people in the import business doubt it as well.

Japanese industry, by way of comparison, has no protective tariffs or quotas, no tariffs at all, as a matter of fact. And when a major Japanese company was about to go under a few years ago the Japanese Government said, in effect, "let them go. We don't need that many automobile companies."

There were no special Government guaranteed loans. There were no special wage concessions from the labor union. There were just the cold, hard facts of economic competition and the company survived. And it is now the most profitable subsidiary that the Ford Motor Co. has. But there was no Government interference. When I hear the word targeting and I hear the automobile industry listed as one of those that was a targeted industry, I have to think these people haven't really been aware of the almost open warfare that existed for years between the Ministry of International Trade in Japan and the automobile industry in that country. They have been at each other's throats for 20 years. MITI originally felt that there was no future in automobile exports in Japan and that the country shouldn't have more than two automobile companies because it was a waste otherwise.

Well, they now have eight, and they are all immensely profitable and successful, and they are still fighting MITI.

When we went over there and advised them that they were going to have to put quotas on their shipments to this country or face Government quotas that would be a heck of a lot more restrictive, they were very unhappy with it. They said;

> You are asking us to become what we have never been but what you have always accused us of. You are asking us to become Japan, Inc. You are asking us to go under the wing of MITI and we have always resisted that. We have always been independent and you are telling us that that is what we have to do.

And they didn't like us very much at that time.

That is my essential statement, Mr. Chairman. I would just like to close on one note and that is that ameliorating the trade relations between the United States and Japan is going to depend on progress in a lot of areas. It is going to require an improvement in our own economic conditions, a return to sanity in interest rates, and the reestablishment of a reasonable exchange rate between the dollar and the yen. It is going to require that American industry make an aggressive, well financed and persistent effort to achieve its full potential in the Japanese market.

I think, first of all, we have to clear away the miasma of misinformation and myth surrounding our relationship with Japan and arrive at a clear, general understanding of the facts of trade between the two nations and the degree of our mutual dependency on that trade.

[The prepared statement follows:]

STATEMENT OF THOMAS NEMET, CHAIRMAN, AND ROBERT MCELWAINE, PRESIDENT, ON BEHALF OF THE AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION

SUMMARY

An understanding of U.S.-Japan trade relations is complicated by widespread misconceptions, anecdotal history and a proliferation of frequently inaccurate accusations of chicanery. Principal among these misconceptions is that the U.S. market is substantially more open than foreign markets and, in particular, that the United States market is free and open to Japanese goods, while theirs is closed to our exports.

Vital to any understanding of the nature of the U.S.-Japan trade relationship is the link between our trade conflicts and the state of the yen-dollar relationship. The exchange rate is the principal reason for the present imbalance in U.S.-Japan trade. Economists agree the disequilibrium is due to an overvalued dollar, bloated by record-high interest rates and not the disproved charge that the Japanese are manipulating the yen to depress its value against the dollar.

A 200-yen-to-the-dollar ratio is possible in the coming year because of a continuing correction in the U.S. and Japanese interest rates and anticipated reduction in OPEC prices for oil which has a strengthening effect on the yen.

Charges of unequal market access are not supported by the facts. The average Japanese tariff level is lower than that of the U.S., and that of the Common Market, as well. The U.S. has overt non-tariff barriers applied to 34 percent of the market for U.S. manufacturers while Japan's apply to only seven percent of its market.

Misinformation about U.S.-Japan trade seriously threatens the 7,000 American businessmen who depend on the sales and service of imported automobiles in this country and their 165,000 American workers who have been asked to suffer the consequences of an overvalued U.S. dollar, outrageously high interest rates and the economic recession of the past couple of years.

Trade barriers to shelter the battered U.S. automobile industry include the highest tariff on trucks imposed by any industrialized nation, a discriminatory tariff on automobiles that permits U.S. companies to import cars duty-free from Canada while imposing a 2.8 percent duty on all other imports and a quota on Japanese cars in place since April 1, 1981.

The U.S. Congress continues to be pressured to legislate import restrictions, particularly with Japan, when the solution to our trading with Japan should be directed to export expansion.

STATEMENT

The greatest obstacle to any rational analysis of United States-Japan bilateral trade relations is the difficulty in separating myth from reality. The concept that the U.S. market if free and open to Japanese goods, while theirs is closed to our exports has become so generally accepted, so much a part of the popular wisdom, that to deny its validity is on a par with claiming the world is flat.

The origins of this concept may have been in the barrage of pre-negotiation statements some administrations have unleashed to soften up Japanese trade negotiators and to pressure them into taking meaningful action. Unfortunately, such pronouncements tend to be taken at face value by the American media and they have become intergrated into the fabric of folklore which now surrounds United States-Japan relations.

The 7000 American businessmen and the 165,000 American workers who depend on the sales and service of imported automobiles in this country for their livelihood and their business life are seriously threatened by the lack of understanding regarding United States-Japan trade relations. Our members are grateful to this committee for calling these hearings and for attempting to provide factual information on the greatly misunderstood topic.

It is vitally important that the realities of our trade relations be understood accurately by the American public. Unless the present miscomprehension about the true state of our commercial relations with Japan is replaced with understanding there may be an emotional reaction that will lead to great pressure on the Congress to take actions that could lead to the breakdown of the world trading system and the collapse of our own economy.

What, then, are the realities of United States-Japan trade relations? Is it, really, a one-sided relationship in which the United States offers Japan unrestricted access to our markets while theirs are closed to us? Economist William R. Cline, writing for the Institute for International Economics, says no.

"The widespread perception that the U.S. market is substantially more open than foreign markets has little empirical support," he writes. It is true, of course, that the United States suffers a substantial deficit in its merchandise trade with Japan. According to the United States-Japan Study Group, however, when one considers all goods and services including the "invisible trade" and long-term capital accounts, the actual balance of payments is in the U.S. favor.

This is borne out by the official figures, showing that Japan has become a leading net exporter of capital. In only the first seven months of the present fiscal year, Japan recorded a deficit of $12 billion in its long term capital account. The current Japanese payments balance remains in deficit, despite the merchandise trade surplus the country enjoys.

It is also true that Japan has endeavored to protect some of its industries and much of its weak agricultural sector with a variety of trade barriers, but so has the United States and so do most of the other nations of the world. Nevertheless, even if Japan were to eliminate all barriers to imports, tariff and non-tariff, economists claim the consequences would reduce the U.S. deficit by less than one-twentieth.

The U.S. deficit with Japan is, therefore, "structural" in nature and not likely to be balanced by any tinkering with duties, quotas, inspection systems, standards or other red tape. Indeed, the Japanese, for the past several years, have been extremely accommodating in easing and removing barriers to the importation of American goods. They have responded to Adminstration pressure by placing quotas on their own automobile exports to this country and in dismantling many of the more onerous strictures previously placed on U.S. exports.

The most frequent accusation against the Japanese is that they have manipulated the yen in a manner designed to depress its value against the dollar and thereby make Japanese exports cheaper. Economists disagree. They claim the disequilibrium is due to an overvalued dollar, bloated by record-high interest rates. As proof, they point out that, concurrent with the 1980–82 rise in U.S. interest rates the dollar appreciated by 40 percent against the pound, 55 percent against the French franc, 28 percent against the mark and 27 percent against the yen. If the Japanese are manipulating the yen, they also seem to be manipulating every other currency in the world with even greater success.

Japan lost $8 billion in a vain attempt to shore up the value of the yen through intervention in the monetary exchanges late in 1982. When U.S. interest rates began their precipitous fall in November 1982, the yen responded quickly, rising from 277 to the dollar to the present level—around 230 to the dollar.

There is no fact more significant to an understanding of the nature of the United States-Japan trade relationship than the link between our trade conflicts and the state of the yen-dollar relationship. The three major trade disputes involving our two nations (1970–71, 1976–77 and 1981–82) have all come at a time when the dollar was disproportionately valued in relation to the yen.

If, as many have charged, our trade deficit with Japan was due to protectionist barriers in that country, there would be no discontinuity in the trade conflict. Protectionism is a continuous process; in an era of floating rates, the dollar-yen relationship is in a state of constant flux. All available evidence indicates that the exchange rate is the principal reason for the present imbalance in United States-Japan trade.

Economist William Cline, of the Institute for International Economics, says today's trade problems with Japan are "driven mainly by an overvalued dollar and an undervalued yen (resulting broadly from a tight money-loose fiscal policy mix in the United States and the opposite mix in Japan)."

Several current trends give reason for anticipating a continuing correction in the yen-dollar exchange rate. A reduction in the difference between United States and Japanese interest rates is expected to continue as commercial and consumer interest rates in this country gradually catch up with the decline in inflation and reductions in the Fed's discount rate. This will serve to reduce the flight of yen into dollars, thereby eliminating the chief cause of the imbalance.

The increase in the value of the yen also has reduced Japan's oil costs, since oil prices are set in dollar terms. The correction in the yen-dollar ratio, therefore, has a synergistic effect for Japan.

The anticipated reduction in OPEC prices for oil should also have a strengthening effect on the yen, reducing the outflow of capital and improving Japan's balance of payments.

As a consequence of these developments, it is possible to foresee a 200-yen-to-the-dollar ratio in the coming year which, after the usual lag in indicators, should go far towards redressing the trade imbalance between the nations.

The principal charge leveled against the Japanese is that of unequal market access. An examination of the United States and Japanese markets for imported goods that does not focus on anecdotal history or specific and frequently trivial complaints about overly strict enforcement of standards and inspections, but rather takes an overall view of the accessibility of the two nations' markets tends to disprove such charges.

The average Japanese tariff level is lower than that of the United States (and that of the Common Market, as well.) By accelerating its tariff reduction schedule voluntarily, Japan has increased the disparity. Recently, Japan acted unilaterally to make substantial cuts in the tariffs on politically sensitive items including cigarettes, chocolate, and biscuits.

In the area of non-tariff barriers, where Japan has been the butt of many accusations of "unfair" practices, the United States seems to be far more vulnerable to such charges. Major, overt non-tariff barriers are applied to 34 percent of the market for U.S. manufactures and only seven percent for Japan's. U.S. non-tariff barriers include restrictions on automobiles, textiles and apparel, footwear, television sets, and steel import quotas with the European Community. In addition, many states have imposed substantial barriers to imports, including state Buy American laws and agricultural restraints. It is not widely known, for example, that 44 states prohibit the entry of Japanese mandarin oranges.

When it comes to specific sectors or products, there are many examples that belie claims of a closed market in Japan. The ubiquitous Coca Cola is the largest selling soft drink in Japan and McDonald's golden arches are prominent in Tokyo. Schick razor blades shave 70 percent of all Japanese chins, while in the field of high technology, IBM and Sperry jointly hold a 56 percent share of the Japanese market for large capacity computers. Nestles's commands a 70-percent share of Japan's booming instant coffee market.

Japan's inefficient agricultural industry and the barriers the government has erected to protect this politically potent bloc have long been a sore point in U.S.-Japan trade relations. To hear the charges, seldom made by U.S. agricultural groups, but usually made by American industries seeking protection against Japanese competition, it is virtually impossible for Americans to export beef, citrus products or tobacco to Japan. The facts do not support this contention. Japan is the largest customer we have in the world for our agricultural products. There is more land in America devoted to raising food for Japan than there is land under cultivation in Japan.

As for the specific commodities mentioned, Japan buys more beef from the United States than does all the rest of the world combined. Japan is also our largest customer for citrus—forty percent of all our citrus exports goes to Japan.

Japan has found ways to limit shipments of finished American cigarettes into that country, but remains our largest customer for tobacco. More than half of the tobacco consumed in Japan comes from the United States. The Japanese Government recently reduced the tariff on finished cigarettes and moved to open more retail outlets for finished American cigarettes, but the American farmer couldn't care less whether he sells his tobacco to Japan or to R.J. Reynolds & Co.

We hear a great deal about Japan's protected agriculture, but very little is said about American restrictions or agricultural imports that are, in many cases, equally as stringent as the Japanese'. We maintain quotas on sugar, dairy products, wheat, peanuts, cotton—and we restrict beef imports to 12 percent of our market, while Japan permits imports to take 23 percent of its market.

In no sector has the xenophobic attitude toward Japan been so feroucious as in the automobile industry. Detroit manufacturers have propagated the illusion that they operate in a state of mutual antagonism with their Government while Japanese manufacturers and the Japanese Government mutually conspire to wreck the U.S. industry,

Reality shows that the American automobile industry is far more protected than the Japanese. Our Government has erected a network of trade barriers to shelter the battered industry, including the highest tariff on trucks imposed by any industrialized nation, a discriminatory tariff on automobiles that permits U.S. companies to import their product from Canada duty-free, while imposing a 2.8-percent duty on all other imports, and a quota on Japenese cars that has been in effect since April 1, 1981, and will remain in effect at least until 1984.

In addition, the industry has been the beneficiary of government guaranteed loans, numerous changes in the tax code that have reduced their corporate tax liabilities to virtually zero, and the actions of a sympathetic Administration to reduce the regulatory burden placed on the industry in the past.

The Japanese industry, by way of contrast, has no protective tariffs or quotas, indeed, no tariffs at all. When a major Japanese company was about to go under a few years ago, the Japenese government said, in effect, let'em fold. There were no Government guaranteed loans, no special wage considerations, just the cold, hard facts of free market competition.

Much has been made of the limited sales of American automobiles in Japan, but little mention is made of the fact that Detroit sells more cars to Japan every year than it does to all the countries of the Common Market combined.

A frequent complaint against the Japanese is that they manage to restict access to the Japanese automobile market through a combination of "high tariffs, discriminatory legislation, arcane type approval procedures, and bureaucratic delays."

So prevalent have these complaints become that in August 1982, the respected London Economist assigned its Intelligence Unit to do a study on "Motor Vehicle Safety Standards and Product Liability" in Japan. The study concluded: "* * * much of the ciriticism appears to be unfounded. So far as tariffs are concerned, the high wall which protected the motor industry during its infancy has long since been removed. As for discriminatiory legislation, Japanese safety standards are less demanding than those of the U.S.A. * * * . Far from obstructing foreign manufacturers with bureaucratic delays and arcane type approval procedures, the Ministry of Transport has gone to considerable lengths to accommodate them."

The lack of general understanding of our true trade relationship with Japan has brought about an increasingly strident exchange of charges and counter-charges and a growing bitterness in our bilateral relations with Japan. What Ambassador Mike Mansfield properly characterized as "the most important bilateral relationship in the world" has degenerated into petty bickering over trivia. Our present dialogue with Japan resembles the haggling over a purchase of a used car far more than it does an exchange between two of the greatest industrial nations on earth, with global responsibilities and mutual dependency.

In the past year, subjects occupying the capabilities of some of our senior representatives and the front pages of newspapers here and in Tokyo include the Japanese Little League standards for baseball bats and the number of U.S.-made cigarette packages permitted in vending machines. As columnist Joseph Kraft points out, "Embitterment is the inevitable consequence of these constant shootouts over increasingly low-level issues."

Kraft also blames the crisis in United States-Japan trade relations on the failure of the United States to develop a coherent economic strategy. He might have added a second failure—a failure to relate fiscal and monetary policies with our overall global concerns.

Absent an explicit government strategy, says Kraft, contending private interests became the chief authors of U.S. economic and trade policies toward Japan. American interests, subject to competition from Japanese firms, sought and received government help in their commerical rivalries.

Over a span of several administrations, a pattern developed in these disputes. At times, the American industry would follow established procedures and file a complaint against their Japanese competition with the International Trade Commission. If the ITC did not find in their favor, they would turn to the Congress and the administration for relief. At other times, they simply went straight to the Congress.

Then, against a mounting threat of legislative action, the administration would negotiate an agreement with the Japanese that would provide the aggrieved U.S. industry with the kind of shelter it desired. Thus, textile restraints were negotiated under Kennedy; television sets under Johnson, additional textile restraints under Nixon, steel under Carter, and automobiles under Reagan. Consequently, the process of trade negotiation has become increasingly politicized, contributing to the stridency of the debate and deepening the resentment with both parties.

Ameliorating trade relations between the United States and Japan will depend on progress in many areas. It requires an improvement in our own economic condition, a return to sanity in interest rates and the reestablishment of a reasonable exchange rate for the dollar and the yen. It requires that American industry make an aggressive, well-financed and persistent effort to achieve its full potential in the Japanese market. First of all, however, we have to clear away the miasma of misinformation and myth that surrounds our relationship with Japan and arrive at a clear, general understanding of the facts about trade between the two nations and the degree of our mutual dependency on that trade.

Chairman GIBBONS. Thank you, Mr. McElwaine, you do well to point out to us that our hands are not clean. All of us come into this area with a little sin and certainly if there has been subsidy of the Japanese automobile industry it was so long ago and so far past that I have no recollection of it.

There is an apparent consensus of those who have looked at it there is no overt manipulation of the yen. About anything that I can see that would come anywhere close to that is the fact that the Japanese have essentially used the yen as an internal financing and have never let it be internationalized as we have our currency. Now, that is their prerogative but Japan is, of course, a fully developed industrialized nation and we like to have them help carry on the industrial trading system.

We enjoy the great honor of having everybody do busines in our currency but it is kind of like the old story about being ridden out of town on a rail. If it weren't for the honor we would just as soon not enjoy it.

So we would encourage them to complete the internationalization of their currency.

Now, there is an emotionalistic point on the importation of American autos into the Japanese market. It is getting far more attention than it deserves, but there is a problem there and that is on our manufacturer certification. We happened to arrive in Japan almost simultaneously with the announcement that they had changed their process and really I think they honestly believed they had done us a big favor. That same day we happened to have a meeting with the U.S. Chamber of Commerce in Japan, including a vice president and general manager for General Motors. We figured General Motors would be on top of what was going on so we asked the gentleman from General Motors what impact the new automotive impact regulations would have upon the American manufacturer.

His response was, well, I don't have the exact wording of it because it is still being developed but we understand that it will help the Germans but it will not help the Americans.

When we took it up later with the Japanese officials they all seemed to be genuinely surprised that that was the impact of it. Because, as I say, they thought that they were doing something that would remove our problem of importation inspection.

Now, I think most of the members of this committee are familiar with a long process that has nothing to do with importation, that process called homologation.

We realize that that is not directly related to imports. That is a manufacturer option that we tend to want to exercise. But it would seem to me it would remove a lot of the emotional baggage that this issue has to carry if they could just let our manufacturers have the same privilege of self-certifying that we give to theirs. Why can't they?

Mr. **McElwaine**. Mr. Chairman, the situation on that is that the new Japanese certification system would give the American manufacturers the same access to type designation procedures as the Japanese manufacturers themselves have in their own home market. Japanese manufacturers are not granted the right of self-certification in that market nor is anyone else. Under this new process, it would enable American manufacturers to use the same system that the Japanese use and that Volkswagen has been using and BMW has been using.

This is why the American manufacturers would say it will help the Germans and won't help us. That is simply because German manufacturers of BMW and Volkswagen are making cars in Germany to Japanese specifications and then shipping them to Japan. The American manufacturers have never done so. They have never made a car to Japanese specification. They ship cars to Japan right off the American assembly line made to U.S. specifications and then go through the process which you describe, bringing the car into compliance on an individual basis. Naturally those cars have to be inspected individually. We require the same thing in this country.

If an importer brings a car into this country that is not in compliance with our requirements and then modifies it after its arrival it must be inspected and certified individually.

The Japanese have very real problems with the issue of self-certification.

One of the things that they point out is the fact that in the United States, for example, where we have self-certification, our manufacturers have recalled this year almost as many cars as they have made. Where the cars are inspected beforehand such recalls seldom happen and this is the point that they make. They say it is an obligation that the Government has to the consumers not to grant such self-certification. They don't grant it to their own manufacturers.

Mr. **Pease**. Will the chairman yield?

Chairman **Gibbons**. I sure will. Every time I hear it it sounds a little different. Not that you are changing your story but every time I hear it from the American side it sounds a little different. Every time I hear it from the Japanese side it sounds a little different. Maybe I will catch on one of these days.

Go ahead, maybe you can help.

Mr. PEASE. Mr. Chairman, I think the issue is really self-certification as I understand it. As to a particular model, Toyota Cressida or a GM Camaro or whatever, there has to be a certification of the type before it can be sold on the market, is that right?

Mr. MCELWAINE. Yes.

Mr. PEASE. And my understanding is that we allow self-certification, is that right?

Mr. MCELWAINE. That is correct.

Mr. PEASE. Toyota says our Cressida meets your standards and then they start selling them in our market and presumably there is some checkup afterwards whereas when GM tries to sell Skylark in Japan that model has to be certified as a model before it enters the Japanese market.

I was told by GM that that process can be done in the United States and the Japanese will send a technician here to do it but it is a process that takes from 3 to 6 months.

Do you agree with that?

Mr. MCELWAINE. That is the change that was just made. There is a story here in the April 25 Automotive News, Japanese-United States Car Certification. The change is that they will now grant type certification as well to U.S. makers, to anyone, as well as to the Japanese manufacturers. The type certification is available, but that is different from self-certification, of course.

Mr. PEASE. Would you define type certification for me?

Mr. MCELWAINE. This is simply a matter that—a type, in this case the Camaro, which you mentioned. If a prototype is built to the Japanese specification, they will inspect it here in the United States, certify that that type meets the Japanese standards and is eligible for entry into Japan. Afterwards, that type may enter without individual model inspection. However, we have never made such a car in this country.

Mr. PEASE. Camero happens to be the very first one, as I understand, that GM has ever produced for export as opposed to the U.S. market. Type certification won't do any good for Skylark or Skyhawks or any other model; when GM is only selling 40 or 50 copies of the model, it can hardly afford to make a prototype of that model.

Mr. MCELWAINE. I think they may have to look at the Japanese example. Toyota, in its first year in this country, sold four cars, but they were four cars manufactured in Japan and to U.S. specifications. They set up an assembly line; and they did so badly the first couple of years they pulled out of the market, went back home again, and designed a new model and came back and tried again, but they set up an assembly line to make cars for the United States to U.S. specifications. It represented a substantial investment, but they were going to get into this market.

I think if the American manufacturers are going to get into the Japanese market in quantity, they are going to have to show similar perseverance and willingness to invest capital.

Mr. PEASE. When it comes to type certification, even with type certification, that would have to be done prior to the sale of the type in the market. Right?

Mr. MCELWAINE. Yes, sir.

Mr. PEASE. Whereas, if the Japanese want to get certification for the Toyota Cressida, or whatever, they self certify. So the difference between self-certification and precertification continues to exist; is that correct?

Mr. MCELWAINE. It is true, there is a difference. Their cars, however, would be subject to in-use testing subsequently.

Mr. PEASE. After they go on sale?

Mr. MCELWAINE. Yes.

Mr. PEASE. But they do not have to endure the 3 to 6 months delay after they are ready to be sold before they can actually go into the showrooms. I think that is a critical difference.

Mr. MCELWAINE. Part of their self-certification procedure, of course, is the 50,000 mile test on the emission control item and driving a car 50,000 miles is obviously a time-consuming and expensive operation as well. That is part of the self-certification. That must be done before they can certify that the car does meet the standards.

It is not that much of a difference.

Chairman GIBBONS. Does a Japanese car have to be type certified before it can be sold in the Japanese market?

Mr. MCELWAINE. Yes, sir.

Chairman GIBBONS. They have to drive it 50,000 miles?

Mr. MCELWAINE. The Japanese do not have a 50,000 mile test; only the United States has that.

Chairman GIBBONS. I am just talking about selling in the Japanese market now.

Mr. MCELWAINE. Yes.

Mr. PEASE. Mr. Chairman, as I understand it, the Japanese have a 20,000-mile requirement for auto emissions; so the car would have to be driven 20,000 miles to make sure the emissions system works. I don't know what other requirements there are.

Chairman GIBBONS. Maybe we need a United States-Japanese auto agreement like the United States-Canadian agreement.

Mr. MCELWAINE. It certainly would be useful, Mr. Chairman, if we could have a common set of standards, not only for the United States and Japan but for the United States and Europe and all the other auto producing countries. Nobody, to my knowledge, has ever called for an international conference to establish international automobile standards. Every country has its own.

We are getting a proliferation in this country where now various States have their own standards. They have standards on bumpers, standards on lighting, on emissions. For the manufacturer, it is a quagmire to deal with all these different standards.

Chairman GIBBONS. Mr. Jones.

Mr. JONES. Would you comment on the differences in dealerships, Japanese cars that come into this country, and how they distribute their cars versus the distribution process in Japan for American cars? In terms of Japanese exclusive dealerships, Ambassador Smith said that that was a major difference and major shortcoming for American sales in Japan.

Mr. McELWAINE. There are many, many differences. The majority of dealerships in Japan are owned by the manufacturer. They are factory outlets rather than independent, entrepreneurial dealerships such as in this country.

There are, as well, independent dealerships; but the big dealerships, the metropolitan area dealerships are largely owned by the factory, and they are not just exclusive to the factory, of course, since they are owned by the maker of the car, but in many cases, they are exclusive to that particular line. You don't have a Toyota dealership; you have a Toyota-Corolla dealership. They will sell their Cressidas in yet another shop, because they attract a different type of customer, different economic levels.

Chairman GIBBONS. That is kind of like General Motors does their Chevrolet and Cadillacs?

Mr. McELWAINE. Yes. Similar in that respect, except General Motors doesn't own the dealerships as happens so frequently in Japan.

Chairman GIBBONS. You can't sell Cadillacs and Chevrolets in the same dealership.

Mr. McELWAINE. There are several. When you get to the smaller communities where you don't have sufficient market area to support an exclusive line, you will find Oldsmobile-Cadillac dealerships, Cadillac-Chevrolet dealerships, various others.

The main difference is that a lot of dealerships in Japan don't have showrooms. The cars are sold door to door. The salesman goes out with a brochure and knocks on doors, shows the brochure to the prospective customer; and if the customer is interested, he makes an appointment to bring a car back and take him for a ride. But almost no one goes into a showroom, outside of your Tokyo downtown area showrooms which are owned by the factories.

That is a great difference. That has been a great handicap in the sale of American cars in Japan. No American manufacturer has ever produced a brochure in Japanese. The only literature available on American cars in Japan is in English. So, your door-to-door selling is obviously going to be very limited.

Mr. JONES. If General Motors decided to do a door-to-door operation like that, is there any reason they couldn't do that?

Mr. McELWAINE. No. They certainly could.

Mr. JONES. Nothing to stop them?

Mr. McELWAINE. They would have to set up, certainly, a better distribution arrangement than they have at the present time. As I say, the fact that the dealerships are owned by the factories makes it more difficult for them to go in and duel. If you have a dealership owned by Toyota, they are not generally going to sell General Motors cars out of a Toyota-owned dealership.

There is another myth involved here, Mr. Jones, which goes way back. We hear all the time how the Japanese manufacturers got their start in this country by selling their cars through General Motors showrooms and making deals with General Motors or Ford dealers. I got concerned about this and went back and looked it up with each of the manufacturers. I found as early as 1972, 80 percent of all Toyota dealerships were exclusive dealerships, not in any way tied in with the domestic dealerships.

The myth that they started their distribution operation by hanging onto the tailcoats of the domestic manufacturers is not so.

Mr. JONES. Mr. Chairman, I think this testimony has provided a lot of good balance. Some of the things you point out are very accurate. We are not all clean in this. Let me just ask you: I share the chairman's frustration on the automobile question. It seems like the stories on both sides slide just a little bit this way, a little that way. It is hard even to get hold of the mush.

I am not really sure who is at fault, but if we were to put on a chart side-by-side requirements, would your organization have any objection to requiring that the Japanese exporter meet the same standards, the same procedures, the informal and formal procedures at the dock, everything else as an American exporter to Japan?

Mr. MCELWAINE. I think it would probably reduce our costs. This is a study that the London Economist Commission—done by their intelligence unit, as they call it—did on this whole business of type designation, type approval, standards, the whole thing.

Their conclusion was that the Japanese restraints were less onerous than the United States and the Japanese standards were easier to meet and that far from obstructing imports, the Minister of Transportation was going to great lengths to help automobile imports come into the country because he recognized the political damage that was being done by the stories about their restrictions.

Mr. JONES. So in terms of reciprocity, if this country were to put on paper that this is what an American automobile manufacturer has to do to get his car into Japan and say these are exactly the same things we would ask of the Japanese exporter to the United States in automobiles, you would have any objection to something like that?

Mr. MCELWAINE. I would not. I don't think it would complicate our importation at all.

Chairman GIBBONS. Put on a 25-percent tariff, too.

Mr. PEASE. Will the gentleman yield? That means you would have no objection to a requirement that a precertification of Japanese cars as to type and model be imposed before they could be sold in the U.S. market?

Mr. MCELWAINE. No; since the Japanese manufacturers have to meet that same standard to sell in their home market, I am sure it would present no problem to selling here.

Mr. PEASE. Good. That is a good endorsement for us to have. I think we ought to proceed along that line.

Chairman GIBBONS. Get rid of that 25-percent tariff. They can start manufacturing Japanese cars in my district again.

Mr. MCELWAINE. May I ask Dr. Fisher for a comment particularly on the Houdaille case? I know he has put in time studying it.

Mr. FISHER. Two things. First, to try to answer Congressman Jones' point about the ability of U.S. car companies to sell door to door in Japan, I can tell you Avon has been extremely successful in Japan selling door to door. They do it, so this is a case of U.S. multinational enterprise which has made an effort to sell door to door in Japan.

They do it a little differently. They have what they call an introducer. It is a woman who lives in the neighborhood and knows everybody. The introducer introduces the Avon lady to the people who live in the house. Introductions in Japan are very important. You don't just knock on the door and say, "Hi, I am the Avon lady."

The way we work and the way the U.S. auto manufacturer should consider this is to try to approach the Japanese market in a Japanese fashion where they do have door-to-door salesmen who are introduced by people who know the people who live in the neighborhood. I believe they would be successful.

Mr. JONES. Is the Avon lady Japanese?

Mr. FISHER. Oh, yes. Absolutely. They are peddling Avon products, but the Avon lady doesn't knock on the door and say, "Hi, I have lipstick." She is introduced, they have tea, go through the ceremony. Then she comes back the next time and sells. But they know her. It is important to have introductions in Japan.

The businessman finds this when he tries to do business there. There is a certain way to do business in Japan. It is important you communicate in the language with nationals and have introductions. It takes a lot of time and effort. U.S. car companies have not made that effort.

Avon is a real success story in Japan and proof you could sell door to door if you wanted.

Mr. JONES. How many other industries concentrate on the door-to-door aspect of sales?

Mr. FISHER. Amway is successful in Canada, in Europe—as far as Japan, the only one I am aware of who has made this immense effort successfully is Avon, but there may well be others, like Amway.

Mr. JONES. Would appliances be sold on a door-to-door basis?

Mr. FISHER. I am not aware of the extent.

Mr. JONES. Other than home products, would you have other durables, other than automobiles, marketed that way?

Mr. FISHER. I don't know the extent to which Mitsubishi sells on a door-to-door basis. There are large department stores. The Avon lady you also find in the department store. They use that to enhance the recognition factor. But it is certainly worth looking into for the automobile companies as a form of distribution.

As far as the Houdaille case, there has been much discussion by the prior witness about the decision this morning; and I would only say I was not here for the first two witnesses, but this was a discretionary decision. It was one that was entirely in compliance with the law.

To the degree there were subsidies, it seems to me the countervailing duty law is there to address subsidy situations. The proper remedy was the countervailing duty law, if indeed that was the contention.

Chairman GIBBONS. I realize the Houdaille case was not a dumping case. It was not a countervailing duty case. It was a 301 case. Not a 301 case——

Mr. JONES. You heard the previous witness on the machine tools. Do you disagree with his basic argument?

Mr. FISHER. I would say this: the proper statute for them to proceed under is 232. Should there be a case, it would be in national security. That is the way they should have gone in the first instance in my opinion. The President will have to look at all the factors and make a decision as to whether or not to grant quantitative restraints or relief based under 232.

I think they made a major mistake in trying to cross tax policy with trade policy by going under 103 initially. I don't think that is a good way to go. It would be a poor precedent for many other industries, such as electronics, shipping, and others, which you could argue are cartels.

The unusual thing about the machine tool industry was that they did not argue the prices had been increased, but rather lowered. That is not the classic cartel. I think the facts certainly didn't support relief.

Mr. **Jones**. Isn't that sort of a classic antitrust violation in Japan, unlike ours?

Mr. **Fisher**. The statute talks about—uses the word "cartel." The industry fixed on that word to say that that should be the basis on which relief should be granted. The classic operation of a cartel is to monopolize a market through predatory practice and increase the price. This is the general view of a cartel and how it is supposed to operate.

The Japanese, by contrast, were offering their product at a lower price. Whether or not there was dumping is a separate issue entirely. That would depend upon what the home market price was. If they thought they had a dumping case, they should have filed a dumping case. Again, they went under the wrong statute.

Mr. **Pease**. Mr. Chairman.

Chairman **Gibbons**. Mr. Pease.

Mr. **Pease**. Mr. McElwaine, I read your testimony, and I find it fairly typical of a lot of the testimony that comes before this committee in that it asserts that the charges of protectionism on the part of the Japanese are vastly overstated. As I read through your testimony, the technique is the same from item to item to item.

You start out saying that charges of barriers are not supported by the facts. Then you stress generally how well we do in a given area, raw tobacco, for example, as opposed to cigarettes or agricultural products generally as opposed to oranges and beef. Then you list what progress we have made in the specific areas. Then you move on to the restrictions that we in the United States have.

I think the point is—at least for me—not how restrictive we are, but how restrictive they are. To say that we ship a fairly high percentage of our beef and citrus exports to Japan and that we ship a great deal of agricultural produce generally to Japan is not to say that the Japanese don't have a restrictive market on beef and citrus. We could ship a heck of a lot more than we do if they would remove those restrictions.

The same thing is true for tobacco. We are shipping some cigarettes to Japan. We are shipping a lot of raw tobacco; but that doesn't say that there are no restrictions either in the Japanese market, and it doesn't say that we couldn't have a vastly increased export market for our finished cigarettes if there were no restrictions.

I just wish that in this testimony that you have given we could narrow it down to whether the Japanese market is restrictive.

Let me ask you: You still maintain that there are virtually no restrictions in the Japanese market?

Mr. McElwaine. I hope my testimony didn't give the impression that I am saying the Japanese have no restrictions. What I intended to say was that the statement that our market is free and open to Japanese goods while theirs is closed to ours is myth, that in essence, our market is perhaps no more open than theirs.

I specifically apply that to the automobile market where we have probably more expertise than we do have in any other field. It would be foolhardy to deny that the Japanese do have restrictions on various imports.

Mr. Jones. What did you say? Their restrictions on total beef?

Mr. McElwaine. They restrict beef imports to 32 percent of their market.

Mr. Jones. We restrict it to 8 percent?

Mr. McElwaine. That is right, sir. And again we ship more beef to Japan than we do to all the rest of the world put together, so it is a substantial market for beef for us. It could be a bigger market, certainly, without the existing restrictions.

Mr. Jones. There are 44 States that prevent the import oranges from Japan; no shipment of any kind of Japanese oranges in those 44 States?

Mr. McElwaine. In those 44 States, for inspection reasons, reasons given that they cannot control the Japanese beetle infestations, mandarin oranges are forbidden to be sent across the State borders.

Mr. Pease. Mr. McElwaine, could you speculate on why it is that the U.S. auto manufacturers, the French, the Germans, the British, the Italians, everybody combined, is able to penetrate the Japanese market only to the extent of 1 percent of this market?

Mr. McElwaine. I think there are a lot of reasons for it. One is that it obviously is an extremely difficult market to penetrate simply because of the product that is available there. As an executive of one of our major domestic automobile companies said, "We can't compete with them in Detroit, how the hell are we going to compete with them in Tokyo?" It is a tough market to crack.

They are making an extremely fine product at an extremely competitive price. If you are going to break into that market, you have to go head to head with the most fierce competition in the automobile business anywhere in the world. Eight Japanese automobile companies, all producing different models and all producing very high quality cars that are very competitively priced, that is a tough market to break into.

You are going up against an inbred Japanese prejudice against foreign products, in particular in the automotive field. You are going up against demands for quality and fit and finish on the part of the consumer that are unlike those anywhere else in the world.

Volkswagen has managed to penetrate that market to the total of about 25,000 cars a year. BMW has increased their sales in that market by 120 percent in the last year.

Mr. Pease. From what? 10 to 22?

Mr. McElwaine. Very little. But BMW sees that as a sufficient growth market to have established an assembly line to make cars for the Japanese market and to have established a Japanese distribution organization; and they are going after that market very strongly.

Mr. PEASE. How many cars did BMW sell in Japan last year?

Mr. MCELWAINE. I don't have those figures with me. I read a story about it just within the last couple of days. I would like to give you an accurate figure on it. I would hate to make a stab at what I thought it was from memory. I will send it to your office, though, if I may, Mr. Pease.

Mr. PEASE. Thank you.

[The information follows:]

[From the Liberal Star, Nov. 10, 1982]

LUXURY CAR STRATEGY SPURS BMW JAPAN SALES—46.2 PERCENT SALES GROWTH ACHIEVED THIS YEAR; 20 PERCENT CONTINUAL AVERAGE INCREASE EXPECTED

A BMW newspaper advertisement recently caught the attention of Japanese car enthusiasts. The advertisement, which occupied a full page, announced the production of 200 limited-edition, German-made automobiles to be sold in commemoration of the first anniversary of BMW Japan Corp. The value of these cars, as special models, can be expected to increase year by year.

A surprise was in store that day for the president of BMW Japan Corp., Yoji Hamawaki, who had sponsored the advertisement. "Amazingly, the 200 limited-edition cars were sold out within the day," he said with excitement. "The advertisement was far more efficient than we had expected. This affair primed the pump, causing brisk demand for our other cars."

BMW Japan, established in October 1981, is an entirely financed subsidiary of BMW AG. BMW AG, with head offices in Munich, is the first European auto maker to launch a subsidiary in Japan. Recent statistics show marvelous progress over the past year. The number of registered new BMW cars has increased by 46.2 percent, in comparison with the same period last year. This growth rate easily surpasses that of other major import cars. According to Hamawaki, such a high growth rate is probably unprecedented. But he prudently added, "BMW Japan Corp. will strive for a continual average increase of 20 percent, but will avoid an increase rate beyond that. Excessive sales expansion would only cause negative effects such as stock troubles, unnecessary price reductions, and so forth." Hamawaki stresses that the underlying reason behind BMW Japan's striking record in the Japanese market, which has a reputation for impenetratibility because of non-tariff barriers, is that BMW AG has a special management strategy. The approach established a few years ago is to produce high-grade cars with special features, and thus to explore the worldwide demand for deluxe cars.

BMW AG holds a 60 percent share of the overseas and a 40 percent share of West Germany's domestic automobile sales. Half of this 60 percent overseas share is controlled through a direct sales system of BMW's subsidiaries. BMW Japan Corp. is the 11th of 12 such overseas subsidiaries. BMW Japan Corp. invested 3 billion yen in its establishment. It opened 45 sales service shops, employed the best salesmen available, and mounted a strong campaign to gain the interest of deluxe car fans. Hamawaki reflects, "The motorization of Japan entered its mature period. There is now a demand for more personal automobiles of a higher quality. BMW Japan's entrance was timely."

Moreover, BMW Japan Corp. is the first company financed under the Impact Loan. It borrowed a total of 15 million dollars from the Import and Export Bank of Japan. The money was earmarked by BMW Japan Corp. for importing four-wheeled and two-wheeled vehicles. Hamawaki extended his thanks to the Japanese Government for the cooperation which made this possible.

As a side note, the record for imported cars in the Japanese market for the first half of this year shows a 10 percent drop in comparison with last year. The market hovers at its previously set base. Import of U.S. cars is particularly sluggish.

Hamawaki proposes that BMW's survival tactic has been to export deluxe cars; U.S. cars have a large domestic market, and he supposes that their policy has been to export the surplus only. In sum, it is a vastly different approach.

BMW Japan, which up to now has challenged the Japanese market with enormous investment and indomitable resolve, should continue giving spirited competition in the future.

BMW Japan Corp.:	
Investments (million yen)	2,970
Personnel (as of September 1, 1982)	254
BMW Consolidated (worldwide):	
Sales DM (million)	9,545.0
Investments DM (million)	883.4
Personnel	44,648
Total export	210,500
Export share in (percent)	60.3

Mr. PEASE. So, you would agree that the Japanese market is a relatively closed market?

Mr. McELWAINE. I would say it is no more a closed market than the American market in most cases.

Mr. PEASE. We were told this morning by USTR that on a scale of 10, with the American market being open—you were here—the Japanese market would be at about 2. That is substantially different from what you are telling me.

Mr. McELWAINE. That is right. I was here. I heard that. Again, I had the terrible feeling of trying to convince the committee that the world is flat, because that is not my concept at all.

I can only feel that the negotiators with the Japanese feel that it would be a sacrifice of their negotiating position to agree that we have anything like equal access right now. It might give away a bargaining position, but it is certainly a position I cannot agree with.

Mr. PEASE. One last question, Mr. Chairman. Your members sell Japanese cars in the U.S. market; right?

Mr. McELWAINE. And European cars; all cars, yes, sir.

Mr. PEASE. What can you report to us on the relative quality between Japanese cars sold in the U.S. market and those cars made in Marysville, Ohio, by Honda? Do you have any report on that yet?

Mr. McELWAINE. Well, I do know the Honda people are going to extraordinary lengths to insure that the cars they make in Ohio match the quality of the cars that they make in Japan. It isn't just a matter of inspecting the cars after they are made; it is a matter of insuring that the cars are made in the fashion that they don't need inspection.

They are producing them at an extremely slow rate initially. I would say the earliest cars coming off that line probably have a production cost in excess of $20,000 a car. A person who is buying those cars for $8,000 and $9,000 is getting an incredible bargain; but once they get the production line going and they are convinced that the quality is as good as the Japanese cars, then they will start making cars at a much higher rate of speed.

It is their expectation to match or exceed the quality of the Japanese cars. Certainly Volkswagen has felt from the beginning that the cars they make in Pennsylvania are of equal quality with the cars that they make in Germany.

I see no reason why the Nissan trucks that come out of Tennessee or the Hondas from Marysville or the Volkswagens from Pennsylvania or the Toyotas from Freemont, Calif., will not all be of a quality equal to the Japanese cars.

Quality is not a function of labor. That has been established many times over. Quality is a function of management. If management makes a decision to achieve the kind of quality they want, and to invest the necessary capital to achieve it, they will, regardless of labor.

Volkswagen makes their old Beetles in Mexico and the quality is every bit as good as the Beetles that were made in Germany. You can make good cars anywhere in the world.

Mr. **Pease**. Very interesting comment. Thank you very much. I appreciate it.

Chairman **Gibbons**. Thank you.

Mr. **Frenzel**. Mr. Chairman, I don't want to inquire, but the gentleman mentioned a study by an economist named Kline. I wonder if the gentleman would provide that to me or to the committee?

Mr. **McElwaine**. Yes, sir. I have to get it from Dr. Fisher here because he stole my only copy.

Mr. **Frenzel**. If we have it, that would be helpful. Was that the source of your comment that if Japanese barriers were eliminated, our deficit would decline by about 5 percent?

Mr. **McElwaine**. Yes, sir.

Mr. **Frenzel**. Thank you very much. I didn't find your testimony typical, by the way, as the gentleman from Ohio did. Most of our witnesses have taken quite a different point of view. I think it is important to point out that our market is rather restrictive, particularly since in the last 2 years—or last 3 years when the voluntary auto restraints have been instigated and the steel restrictions have been negotiated, that changed us from being a free market, with some aberrations, to being a closed market.

I thank you for pointing that out. I yield back my time.

Chairman **Gibbons**. Thank you.

Our final witness today is the Metalworking Fair Trade Coalition. I have not only read your statement, but I have watched you waiting patiently. Come forward.

STATEMENT OF ROBERT J. BLINKEN, CHAIRMAN, MITE CORP., NEW YORK, N.Y., ON BEHALF OF THE METALWORKING FAIR TRADE COALITION

Mr. **Blinken**. I am not going to read my statement.

I appreciate the privilege of addressing this committee again. The last time I was asked generally about the constituency of the Metalworking Fair Trade Coalition. As I reported at that time, we represent approximately 27 trade associations the metalworking field, with normal employment of the member companies of approximately 1.4 million.

We did a survey informally since the last time I appeared here. We found that member companies are located in over 85 percent of the congressional districts of the United States, so that while we look at ourselves as a smokestack industry-type group, and we tend to think of ourselves as being concentrated in the Midwest, the fact of the matter is we cover the gamut of industry in the United States pretty completely.

I would like to respond for a moment to some of the comments made earlier today. Mr. Pease raised this scale of 1 to 10 question, which I think was an interesting one, and made reference to results-based policy and to the question of comparative advantage.

I think I could speak for most of the companies in our group who have had the experience of, themselves, reciprocal trade with Japan—most of us have sold things there and bought things from Japan—that we would generally be much more in favor of results-based approaches to these problems than any other approaches.

I think when one looks at the question of comparative advantage, he has to go into the greatest comparative advantage of all. The Japanese have had 35 years in which public policy in this country has encouraged the importation of their products.

This was first public policy and the repeated advocacy of free trade by almost every administration and every Congress we have had during that period of time. The general American attitude, which is one of openmindedness, fair play, the guy that gives you the best product at the best price is the guy entitled to make the sale.

That is the American attitude. We also have had the other extreme in the development of that situation. We have had consumer groups testifying before various tribunals such as the International Trade Commission who were financed completely by Japanese industry.

Our point is that the greatest comparative advantage the Japanese have in reciprocal trade is the tremendous psychological barrier to the purchase of foreign products in Japan as opposed to the almost opposite attitude in the United States.

Virtually everybody—economists, politicians, travelers who get stranded overnight—who goes through Japan now writes a book telling American business and industry how it can adopt the Japanese method of operation and therefore become successful.

Another book reviewed in the New York Times today was called "The Japanese Mind: The Goliath Explained." The main point was we don't really understand the Japanese. The book goes on to say that—refers to the exclusionary quality of Japanese society, the fact the only way to win complete acceptance by the Japanese is to be born into their tribe, and goes on to say their loyalty to their institutions—their families, their companies—is something we don't fully comprehend.

I think that is an important problem we have to face up to ultimately. If every tariff barrier, every regulatory, every statutory barrier were eliminated immediately, there would still be certainly 35 years of obvious advantage and many generations of practical advantage in this reciprocity of trade.

We were dealing in today's hearing with certain specific questions. I would like to deal now not with myth or with prejudice but with a case history which I think goes to the point of United States-Japanese trade relations.

I am speaking for the metalworking industry. As I reported the last time I was here, I speak particularly from my familiarity with one facet of that industry, which is the industrial fastener industry. I invite your attention to appendix B of testimony submitted to this committee in February 1978.

The hearing was on import relief of the domestic fastener industry. That appendix described in detail the targeting of the American industrial fastener industry by the Japanese starting in 1964, when the Fasteners Institute of Japan prepared its blueprint for targeting of this industry.

While that was going on, we were having trade association meetings here where all of our lawyers were sitting around making sure no one said or suggested anything that was at all collusive, that gave anybody else a hint of what business conditions were like, because the Justice Department would be descending upon us.

While we were talking about our golf scores and things like that, they were planning how to penetrate industry here.

The fact of the matter is they are very successful. Ten years after that plan was published, the importation of Japanese bolts in the United States increased by 1,000 percent, nuts by 2,000 percent, and cap screws by over 4,000 percent.

At the present time, imports of these products, principally from Japan, are well in excess of 50 percent of domestic consumption in the United States. The important part is that these trade practices are not isolated events.

Each one, as I will illustrate, relates to the next. Targeting does not have to be perpetuated. Once it serves its purpose, its purpose has been served. The purpose has certainly been well served in this instance because with more than 50 percent of the U.S. market, certain events follow which make the process relatively irreversible.

We turn now for a moment to the question of the yen-dollar relationship. I won't get into that debate. Others much better qualified than I have debated this subject. I would point out, for example, as a differnece in style between the United States and Japan, in 1977, the Japanese felt that the yen was overvalued in relation to the dollar, by their perception.

So they instituted a yen appreciation assistance program for Japanese companies exporting to the United States. They offered, among other things, low-cost loans to assist those companies because they were injured by what they perceived to be an overvalued yen.

Over 300 industrial fastener manufacturers in Japan received such loan assistance during that period of time.

Again, a question of difference in style. Now, we go on to tracking the effect of targeting and the relationship of that targeting to the currency situation now. Not only did the targeting of the industrial fastener industry take away 50 percent of the domestic market, but it very effectively destroyed the remaining domestic companies' principal source of supply of steel, because the steel companies, with a rapidly dying customer, clearly could not continue to invest capital in making the special steel required for the industrial fastener industry.

The Japanese very quickly assumed a dominant position in the supply of that steel. I gave testimony several weeks ago on one aspect of that which was the downstream dumping aspect. I will not repeat that testimony; but I would like to indicate how the train of events evolved.

The basic concept of free trade is really a rather narrow aspect of what we would call free markets. Free trade is free markets on an international basis. One of the classical economic checks and balances to a currency situation such as we have between the dollar and the yen would be that with a dollar, we view as too strong in relation to the yen, and related trade problems, we can at least offset part of our problem by using those strong dollars to buy yen-based products at an advantageous price.

In the case of the American fastener industry, we are extremely dependent on Japan for the better grades of steel used to make fasteners. I have been trying to buy that steel for my company directly in Japan since I have been in the business.

They will not permit us to buy the steel free on board Osaka or free on board Hokkaido. We must buy it in the United States in dollars through a trading company.

We know the price in yen in Japan is 20 to 40 percent lower than the price we pay here, but there is no real competition in the market. The American mills do not have capacity to make that particular type of steel in quantities that satisfy our requirements.

Strangely enough, as the dollar has appreciated against the yen, the price of that steel has not come down. We are still paying for it in dollars. We are paying the same price. It tracks the American mill price within 1 or 2 percent, no matter what the American mill price does and no matter what the yen-dollar relationship is.

I spoke to one of my factories on the phone this morning, and asked them if anything had changed. All that is changed in recent months is that with the very strong dollar, the price quoted by the American mills who are still supplying this kind of steel is coming down faster than the Japanese price because the Americans are very hungry for business and see an opportunity now perhaps to start to expand their base of operations because of the pricing practices of the Japanese and they are becoming a little more aggressive.

The dollar is strong against the yen, but the purchasing power of that dollar for Japanese goods is not as great as it was.

This interference with the free market makes the whole concept of free trade from our point of view very academic. Free trade is only one way of expressing the situation. We have had a lot of discussions today and in previous hearings which I have been privileged to attend, and we very often get into the good guys-bad guys scenario.

We hear metaphors about sin, even original sin. These are introduced into these matters. This is not a matter of faith or religion. It is a matter, as I said last time, of what is in the enlightened best interests of the United States.

The extreme free trade people occasionally speak of it as an article of faith and occasionally get very Darwinian about it; "Trade policy is not supposed to protect the weak. The strong should survive and the weak should perish." But perhaps 100 years or 200 years from now, when the history of trade matters during this century is written, the writers will conclude from a Darwinian point of view the Japanese deserved to prevail, not necessarily because they were more efficient, but because one of the aspects of Darwinian survival is being able to persuade your government to be more helpful.

They have been more successful at it than Americans have been.

I have no further comments. I would be delighted to answer questions.

[The prepared statement follows:]

STATEMENT OF ROBERT J. BLINKEN ON BEHALF OF THE METALWORKING FAIR TRADE COALITION

My name is Robert J. Blinken. I am Chairman of MITE Corporation, which operates industrial fastener plants in Indiana and Connecticut. I represent the industrial fastener industry in the Metalworking Fair Trade Coalition on whose behalf I appear today. The Metalworking Fair Trade Coalition is made up of 27 trade associations whose member companies normally employ 1.4 million people in almost 25,000 plants and have total annual sales of $75 billion. A list of member associations is attached. The average member company employs only 56 people; yet, in the aggregate, they make up the backbone of the American metalworking industry.

Few of the individual member companies or even member trade associations can afford by themselves to engage in trade disputes and actions against the concerted efforts of the Japanese nation. That is why our coalition had to be formed. The Metalworking Fair Trade Coalition, as its name suggests, favors fair trade and would support so-called free trade if it were a realistic possibility. Within the framework of items four and five of today's agenda, I should like to draw upon my experience in the metalworking industry to cite specific examples of how Japaneses interference with the workings of a true free market makes our country's espousal of free trade totally unilateral, anachronistic and destructive to American interests.

(1) Targeting of competitive industries

I invite your attention to Appendix B of the testimony submitted to this committee on February 27, 1978 during hearings on "Import Relief for the Domestic Industrial Metal Fastener Industry." That appendix described how the Japanese government, in 1964, through the Fasteners Institute of Japan prepared a blueprint of penetration of the U.S. industrial fastener industry. That blueprint spelled out the full gamut of direct government assistance and coordination including government financing of new manufacturing machinery. In the decade that followed inauguration of that plan, import of Japanese bolts into the United States increased by over 1,000 percent, Japanese nuts by over 2,000 percent and cap screws by over 4,000 percent. Imports of these products, principally from Japan, now make up more than 50 percent of U.S. consumption.

(2) Interference with a free market in currency

I am sure you will have heard testimony as to how the yen is devalued against the dollar by Japan's policies of preventing a free yen-dollar exchange market to exist, of limiting severely foreign investment in Japan and maintaining gigantic unconverted dollar reserves.

These actions, in the aggregate, have the effect of depressing the yen against the dollar whether or not that is their primary purpose.

In 1977, the Japanese deemed the yen to be too strong in relation to the dollar. They put into effect a "yen appreciation" assistance program which afforded low-cost loans to exporting industries which were adversely affected by the strength of the yen. According to the July 31, 1978 report by counsel to the ITC, over 300 fastener firms alone received such loans.

In January 1979, a 15 percent additional escape clause tariff on fasteners went into effect. Within about a year of that date, the yen depreciated 23 percent against the dollar, totally obviating the intended effect of the tariff relief. Rather than act to offset this effect, the ITC last year told the industry that extension of tariff relief was not warranted, in part, because continued yen weakness would offset any potential benefit of any tariff relief. This matter is discussed in a Report to the Congress by the Comptroller General dated August 5, 1981.

(3) Interference with free trade in steel

In a true free market, there would be a logical counteraction to the weakness of the yen against the dollar. But Japan has blocked this normal free market mechanism of adjustment. Steel makes up almost 50 percent of the cost of an industrial fastener. The Japanese manufacture excellent fastener steel. The Japanese domestic market price for that steel is from 20 to 40 percent below the price of that steel in the U.S. market. The Japanese consistently refuse to sell that steel to American manufacturers in Japan at the Japanese market price. Regardless of dollar-yen fluctuations, the Japanese offer fastener steel in the United States at the same price in dollars as U.S. mills. In other words, they will not let us use the relative strength of the dollar to offset, in part, the trade advantage which that strength confers upon them, an action which would quickly take place if free trade were a reality.

Their explanation to me has been that they don't wish to offend our government by selling steel at low prices to American manufacturers; but the underlying fact is that they have a two-tier pricing system which gives them a substantial and artificially maintained competitive advantage in our market for their manufactured goods.

The multitier steel pricing system employed by the Japanese affords them the best of all possible worlds. Any direct sales of steel to American manufacturers that might be lost are fully offset by sales in the U.S. markets of an equal tonnage of steel converted into fasteners by Japanese manufacturers. In other words, instead of selling an additional 300,000 or so tons of steel in the United States, they sell that additional weight of steel to which has been added Japanese conversion labor. They remain totally independent of any U.S. steel pricing regulations or bilateral steel quota agreements because they can sell steel in the form of fasteners independent of any such restraints and without fear of competition from American fastener manufacturers who are denied access to low-cost steel despite the strong dollar.

That kind of system does not come into being spontaneously. Central coordination and policing are necessary to make it work.

MEMBERS

Forging Industry Association.
National Screw Machine Products Association.
American Pipe Fittings Association.
National Tooling and Machining Association.
Alliance of Metalworking Industries.
Cast Metals Federation.
National Foundry Association.
Iron Castings Society.
Steel Founders' Society.
Non-Ferrous Founders' Society.
Value Manufacturers Association.
National Association of Chain Manufacturers.
Metal Treating Institute.
American Metal Stamping Association (Washer Division).
U.S. Fastener Manufacturing Group.
Industrial Fasteners Institute.
Hand Tools Institute.
Welded Steel Tube Institute.
Association of Die Shops International.
American Die Casting Institute.
Steel Plate Fabricators Association Inc.
American Wire Producers Association.
Expanded Metal Manufacturers Association.
Tool & Die Institute.
Cutting Tool Manufacturers Association.
Industrial Perforators Association, Inc.
American Cutlery Manufacturers Association.

SUPPORTING ORGANIZATIONS

American Iron and Steel Institute.
Steel Service Center Institute.
Machinery Dealers National Association.
Specialty Steel Industry.
National Machine Tool Builders Association.
Metal Cutting Tool Institute.
Hack and Band Saw Manufacturers Association of America.
National Coil Coasters Association.
Spring Manufacturers Institute.
Cold Finished Steel Bar Institute.
International Die Sinkers' Conference.

Chairm[illegible] GIBBONS. Well, sometimes the best witnesses are last. I hear you

Mr. **Pease**. Mr. Chairman, I thought the testimony was very good, particularly the part about the Japanese becoming the major supplier of steel for our own remaining fastener manufacturers. It is pretty clear from what you said that there is some price fixing going on with that imported steel.

Is that too strong a conclusion to draw?

Mr. **Blinken**. Price fixing may be a technical legal term which I am not qualified to analyze. I can merely say, as a buyer of steel, that I am extremely aware of the fact there is not what I would call a free market in Japanese steel.

As a matter of fact, only a few weeks ago, an importer who is usually on the other side of ITC hearings from me, proposed to sell us some steel from a Japanese mill which turned out to be one of the mills we buy from normally through a trading company.

The price he quoted was quite lower than what we usually pay. I was quite interested. He did not know we were buying steel from them. He said, of course, I will have to tell them who the buyer is. I said that is perfectly OK with me. I asked my purchasing people to follow up on it.

I have gotten no response yet. I am still waiting to see whether that quotation will remain open to us. But the fact of the matter is I did specifically commission an American attorney who normally represents Japanese companies to represent me in Japan last year, in trying to get an agreement for them to sell me steel in Japan, and at the prevailing market price.

They just would not do it. They said trigger pricing was still in effect, and they were worried about that. I said, No. 1, we are nowhere near the trigger price. We are so far above it.

No. 2, that is my responsibility. If I take title in Japan and bring it into the United States, I have to make my peace with the Treasury Department and Customs. Their answer was—it was very convenient for them at the time.

It would be politically embarrassing. The United States would get angry for us selling you steel at a price that is lower. So they have the best of both possible worlds.

In 1974, I went to Japan and when we had an apparent steel shortage here to try to increase our purchases. While no commitments were made, actually the trading company people took me around to visit fastener manufacturers.

They said, "Why don't you import these fasteners instead of buying the steel and making the fasteners yourself?" So you have a coordinated economy. Let's put it that way. I won't say price fixing. We have no comparable mechanism in this country to coordinate our economy.

Mr. **Pease**. We visited South Korea as well as Japan 3 weeks ago. We were told that the South Koreans' steel industry is even more efficient than—and low cost—than the Japanese industry. Have you noticed that the Japanese are buying a lot of South Korean steel to take advantage of those low prices?

Mr. **Blinken**. I have not. We are aware of the rising significance of industry in South Korea generally, because the fastener industry is only half a step above the steel industry in terms of progression of product.

We also see it happening in mainland China, but the Japanese situation is still the predominant one.

Mr. **Pease**. Thank you. We certainly appreciate your testimony. Bill?

Mr. **Frenzel**. I want to thank the witness, too. I know he was before the committee before. His testimony was valuable to us then.

Mr. **Blinken**. Thank you.

Mr. **Pease** [presiding]. This concludes our hearings on United States-Japan trade relations at this time. The hearing record will remain open until the close of business on May 3, 1983.

[Whereupon, at 2:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., March 14, 1983.

Hon. SAM GIBBONS,
Chairman, Subcommittee on Trade, Cannon House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I regret that I was unable to testify at the hearing on the current state of trade relations between the U.S. and Japan, which was held by the Subcommittee on Trade, Thursday, March 10, 1983.

While I am greatly interested in trade relations between the U.S. and Japan and very much appreciate your affording me the opportunity to appear, my schedule did not permit me the time to actually appear to testify. I would, however, appreciate your inclusion of the enclosed Special Order which I delivered on the floor of the House in the last Congress in the hearing record.

Again, thank you for your consideration of this request, and I look forward to working with you and the other members of the Subcommittee on these important trade issues.

Best wishes,

DOUGLAS BEREUTER,
Member of Congress.

Enclosure.

[From the Congressional Record, Vol. 128, No. 151, Washington, Dec. 18, 1982]

A WORKABLE SOLUTION TO OUR TRADE PROBLEMS WITH JAPAN

The **SPEAKER** pro tempore. Under a previous order of the House, the gentleman from Nebraska (Mr. Bereuter) is recognized for 60 minutes.

(Mr. Bereuter asked and was given permission to revise and extend his remarks.)

Mr. **BEREUTER**. Mr. Speaker, several weeks ago, the long-awaited GATT (General Agreement on Tariffs and Trade) Ministerial Conference concluded. Eighty-eight countries met in Geneva, Switzerland, to discuss critical issues relating to the conduct of international trade.

Given the troubled economies of virtually all nations, even our own, proponents of free trade faced a difficult task at this trade conference. With economic difficulties come almost insurmountable calls for protection of domestic producers and manufactuers and an increasing cold shoulder to foreign goods.

As a member of the congressional delegation to this conference, I considered these negotiations to be of utmost importance. Of particular interest to me, because I represent one of the Nation's premier agricultural districts, were the bilateral United States-Japan negotiations. Promised to the anxious farm community in early spring, these discussions were designed to identify and to implement ways to bring down formidable Japanese barriers to the importation of American agricultural products.

In the last few days, we have heard much said in this Chamber about the status of United States-Japan trade relations, and particularly, the imbalances in that relationship. The agricultural trade barriers set up by the Japanese came in for special scorn. Yet, no one in this body offered any workable solution to these problems. The [illegible] debated domestic content bill, the proponents admit, is a flawed vehicle, one with a potential for creating chaos in the international trading system. It does not offer a reasonable or acceptable answer to the problems we encounter in trade with the Japanese.

Today, I would like to reemphasize to my colleagues the important role agricultural trade plays in the American economy and to describe some of the problems American traders face abroad. Moreover, I hope to encourage a search for meaningful solutions to the intolerable United States-Japan trade imbalance by suggesting what I believe to be a promising answer to the agriculture trade barrier conflict.

AMERICA'S EXPORT SUCCESS STORY

Let me begin by first giving a brief description of America's greatest trade success story: The agricultural export market.

America began exporting agricultural products more than 350 years ago with the sale of tobacco to the English. According to statistics gathered by the U.S. Department of Agriculture's Foreign Agricultural Service, our Nation now exports more agricultural products than any other country in the world. More than 150 nations receive U.S. agricultural products. We account for four-fifths of the soybeans moving in world markets, two-thirds of the feed grains traded, two-fifths of the wheat and cotton shipped abroad and one-fifth of the tobacco and rice sold between nations. Earnings from foreign sales of agricultural products have added more than $10 billion to our trade surplus account each year since 1974. In contrast, our nonagricultural trade balance reversed from a $958 million surplus in 1970 to a $50 billion deficit just 10 years later. Over the same period, the farmers and ranchers of this Nation have preformed in exemplary fashion, boosting the agricultural trade surplus from $1.3 billion in 1970 to an amazing $23.2 billion at decade's end.

The value of these foreign markets to the individual farmer—as well as to the Nation as a whole—cannot be underestimated. Presently two-fifths of our cropland—or approximately 138 million acres—produces commodities for foreign sales. Moreover, one-fourth of the cash receipts earned by our farmers and ranchers comes from that vital trade. Expanded markets encourage production efficiencies which engender benefits to the farmer, as well as to the American consumer.

It seems almost unbelievable that in the 1930's, average yearly exports were only $765 million. That figure rose steadily to $2,416 billion in the 1940's, $3,603 billion in the 1950's, and $5,735 billion in the 1960's. Average yearly sales then skyrocketed to $18,370 billion in the decade of the 1970's.

Everyone—consumers, farmers, workers, ranchers—benefits from a health agricultural export program. Multiple values of the export effort can be readily cited.

Although we exported more than $40 billion of agricultural commodities during fiscal year 1980, the U.S. Department of Agriculture estimated that such trade generated twice that amount of activity in the domestic economy and accounted for roughly 1 million jobs. In 1979, almost half a million people were employed on the farm and approximately 680,000 in jobs related to the assembling, processing and distribution of agricultural goods destined for foreign markets. USDA statistics for 1979 tied to our agricultural export effort 60,000 food processing, 300,000 trade and transportation, 120,000 manufacturing and 50,000 other jobs in the economy.

Such statistics take on even more significance when one learns that the value of overall U.S. agricultural exports for fiscal year 1982 dropped $4.7 billion, an 11 percent slide from the previous year, to $39.1 billion. Furthermore, the volume of agricultural exports for the period lagged 2 percent behind the previous year's figures, slipping to 158 million tons. Despite an 11 percent decline in imports, our agricultural trade surplus fell from a record $26.6 billion in fiscal year 1981 to $23.7 billion.

During October of this year, we suffered another distressing decline, as volume dropped 23 percent—to 12.1 million tons—and value fell 26 percent—to $2.9 billion—from the same month a year ago. For fiscal year 1983, the USDA predicts a continued slide, down to $37.5 billion, in the value of agricultural trade.

In certain areas, we did have some good news. For the first 6 months of the year, trade with South Asia, India, and Pakistan was up over 100 percent. Exchanges with Latin American and the Caribbean, however, showed a 33 percent drop over the same period.

Some of the drop in export performance occurs due to circumstances beyond our control. Economic conditions, for example, the Polish debt crisis, explain the 56-percent slump in imports by East European countries. In other cases, the dollar's appreciation has hampered U.S. export performance.

In some cases, however, the USDA reports that movements in the value of the U.S. dollar did not appreciably affect foreign prices. For example: between March 1981 and March 1982, when the yen depreciated 16 percent, Japanese import prices for U.S. wheat, corn, and soybeans fell 3 percent, 17 percent, and 16 percent compared to drops in U.S. export prices of 4 percent, 20 percent, and 16 percent.

Regardless of the cause, the deterioration in export performance is unnecessary. American farmers, poultry men, stockgrowers, and fruit and vegetable growers produce high quality goods in heavy demand worldwide. If economic conditions downgrade market opportunities in one sector, we must pursue any other options all the more aggressively. We must constantly work to penetrate any possible market abroad. Certainly the demand for our goods exists.

Despite the desirability of our agricultural products, we are enduring trade declines because trade barriers in some countries hamper our sales efforts and undermine our ability to overcome temporary economic disincentives to trade.

UNITED STATES TRADE WITH JAPAN

Japan offers the classic example of the deleterious impact of trade barriers, one that is constantly and appropriately cited in this body. It must be recognized that Japan has been our No. 1 market since 1964. Japan purchased $6.7 billion of agricultural goods from us in 1981, up 17 percent from 1980. The second ranking customer, West Germany, received less than half that amount. One out of every 20 U.S. farm acres goes to produce commodities which feed Japan, a figure which represents more cropland than Japan itself devotes to feeding its citizens. Some 90 percent of Japan's high quality beef imports, for example, come from the United States. With food imports by Japan expected to double by the end of the century, our Asian ally offers a fertile market for additional American sales.

Despite the already extensive purchases by the Japanese from the United States, their significant trade barriers still greatly hamper our increased sales to this important market. According to Alan Middaugh, president of the Meat Export Federation, "While the average ad valorem duty on Japanese manufactured goods entering the United States is 2.5 percent of the import duty on U.S. beef is 25 percent."

Japan maintains import quotas on 22 agricultural products an ad valorem tariffs on a number of commodities. Tariff quotas apply to 11 items including corn used for industrial purposes and barley used for feed.

Beef quotas are particularly notorious. For April 1981, to March 1982, beef import quotas were as follows:

	Metric tons
General quota	111,000
International hotel and restaurant quota	3,000
School lunch	2,250
Boiled beef	4,700
Okinawa	5,850
Total	126,800

Quotas change roughly every 6 months, the above quota being 8,000 metric tons less than the previous level. This restricted level allows the annual entry of only 2.5 pounds of foreign beef per Japanese citizen.

Equally stringent quotas apply to fresh oranges and fruit juices. Quota limits cover two periods: June to August and the remainder of the year. A 20-percent tariff applies during the latter period even though virtually no domestic oranges are available during that time. A 1978 requirement that imported juices must use at least 40 percent of their juice from Japanese oranges caused a dramatic drop in the U.S. share of the Japanese market, from 77 percent to 20 percent.

Formal quotas are not the only mechanism used to depress imports, governmental advocacy of voluntary imports, quarantine regulations, health regulations, standards and credit arrangements can all be used to hamper U.S. sales efforts. Purchases of commodities for resale by the MAFF's (Ministry of Agriculture, Forestry and Fisheries) food agency, at a noncompetitive price support of the domestic produce, further discourages purchases from abroad.

If these trade barriers could be eliminated, U.S. sales to Japan potentially could increase in a major degree.

One important unexploited sales opportunity is for pineapple juice, which is not produced in Japan. Another opportunity lies in beef sales.

The following figures demonstrate the potential for enhanced beef sales. Total meat consumption in Japan grew from 3.5 kilograms per person in 1960 to 22 kilograms in 1980, with high quality beef and veal consumption increasing from 1.1 kilogram to 3.5 kilograms per person. Despite this rise, however, that level equals only one-tenth of U.S. beef consumption and one-fourth of that of Western Europe. In 1981, per capita carcass weight beef consumption averaged 11 pounds in Japan, a stark contrast with the United States 106-pound average. With the Japanese diet in transition since World War II and fish stocks off Japan's coast decreasing, its citizenry is becoming increasingly reliant on beef imports for protein.

INTERNAL JAPANESE RESISTANCE TO IMPORT INCREASES

The need for increased imports and the desirability of freer trade policies, however, seem to be ignored by the Japanese, especially the farming sector. Japanese farmers are dead set against any change in the current import policies. On April 23, an estimated 8,000 farmers took to the streets in Tokyo chanting "No more beef, no more oranges," a direct protest against the U.S. request that import quotas on 22 agricultural and fishery products, including beef and oranges, be dropped. According to a report in the May 1982 issue of the London Economist:

"Japanese have been fed with horror stories in the newspapers and on the air waves about what could happen to local agriculture if the Americans were allowed to export more of their cheap beef and delicious oranges. Nightmares of a farming system reduced to the near starvation level of 1945 are conjured up. The Japanese are told that they are already dependent on foreign supplies for nearly half of their daily diet of 2,500 calories. What if the Americans should once again slap embargoes on certain food exports?"

Why the campaign to create mass hysteria? Moreover, why do the Japanese perpetuate an agricultural commodity where the average farm size is less than 3 acres, compared to 450 acres in the United States? Why the campaign in an economy which suffered in 1980 its worst rice crop in 26 years? Why the hysteria when 1981 wheat production was virtually equal to that of 1980, despite a 17-percent increase in harvested area? Why the hysteria when only 13 percent of Japanese farmers are full-time operators and only 14 percent of the land is suitable for agricultural use?

Part of the answer lies in basic Japanese law. The 1961 Agricultural Basic Act, for example, perpetuates small-scale operations. It allows imports to be controlled if they threaten domestic farm prices, thereby keeping domestic prices and income high. The Japanese Ministry of Agriculture, Forestry and Fisheries estimates that such a program cost the Japanese $14.7 billion in 1979, an amount equivalent to 28 percent of gross agricultural income.

Similar subsidy programs benefit Japanese beef producers, enabling the nation to provide 75 percent of its own beef requirements. Although the average Japanese herd size is 5-6 head, a complicated system of prices, supports, import quotas, feeder-calf stabilization schemes, direct grants, and low-interest loans for capital and operating expenses, and direct breeding assistance sustain the Japanese beef producers. Costs are high. By comparison, the average cost of production per hundredweight of slaughtered cattle in the United States in 1979 was $65.74; it was $140.91 for a Japanese dairy steer and $218.27 for a Japanese breed Wagyu steer. As a result, the average retail price of beef in Japan was $6.77 per pound in 1981 compared to $2.40 in the United States. Retail prices for boneless sirloin averaged $14.40 during 1979-81 compared to $3.50 in the United States High demands and artificial limitations on supply, coupled with small scale production, inefficient feeding practices and high livestock mortality keep Japanese beef expensive.

JAPANESE FARMERS HOLD POLITICAL CONTROL

A recent article by Aurelia George in the journal Pacific Affairs provides an explanation for Japanese obstinacy on these points.

It is widely recognized that, in matters of agricultural trade and farm policy, the Japanese government is influenced more strongly by political factors than by considerations of economic efficiency or comparative advantage. The ruling Liberal Democratic Party (LDP) is commonly portrayed as captive of domestic farming interests and bound to the dictates of an electoral strategy aimed at preserving a voting base in rural areas.

Labeled by George as a "well-mobilized and vocal political force," Japanese farmers must be reckoned with in any debate on Japanese trade policy. With membership concentrated in a single association of agricultural cooperatives, Nokyo, 5 million voices and a half million personnel speak together on any political debate, making it the largest single organization in the country.

Indicative of Nokyo's control over the argicultural sector is the fact that virtually all of the rice, over 90 percent of the milk, almost 90 percent of the vegetables and fruits, over 80 percent of eggs and pork and 80 percent of the beef sold in Japan is marketed through Nokyo's 10,000 member cooperatives.

Unchallenged economic power, matched by its political control—especially of agricultural policy—makes Noyko a potent force indeed. It has automatic consultation rights and even acts as administrative agent for numerous programs, including payments to producers. Despite a 43.6 percent decline in the agricultural workforce during 1965-78—from 10.09 million to 4.69 million workers—Noyko remains a potent voting block because total agricultural population declined only 7.8 million during that same period, from 30.0 million to 22.2 million. That figure represents 20.45 percent of the national electorate of 16.2 million eligible voters. Failure to reapportion the Diet since its creation further enhances the electoral power of the rural vote, providing these rural and semirural constituencies 30 percent of the total delegates in the Japanese diet. Given the slow declines in farm acreage and household population expected, Nokyo's ability to expand its services into nonfarm areas and its activism on the part of favored candidates, the agricultural imbalance in the Japanese political system promises to remain in the foreseeable future.

As a result of this political potency, George says:

". . . the LDP allows no major items affecting its rural clients to go unquestioned. In pursuing its stated political objectives of providing market and price stability for farm products, income equity across various sectors of the economy, maintenance of agriculture as a viable industry and security of food supply, the Government has created a comprehensive system of state control and support for agriculture. This system has led to considerable intervention in price determination and in matters relating to agricultural production, development and trade."

Such is the control of the agricultural sectors that:

"Although bureaucracy in Japan has traditionally played an active and decisive role in the policy process, Government decisions affecting agriculture carry such political import that they are not left to the bureaucracy to make."

George said.

DESPITE HIGH PRICES, CONSUMERS SUPPORT THESE POLICIES

Despite the fact that Japanese consumers endure some of the world's highest food prices, they seem allied with the farmers on this protectionist policy. A recent survey in Japan reportedly revealed that 70 percent of Japanese consumers were willing to forgo less expensive imported food stuffs in favor of increased domestic prices. They endure higher domestic prices as well, allocating 32 percent of their consumer expenditures to food compared to 17 percent in the United States. Staples such as rice, bread, and beef sell at two to three times the average world prices.

No constituency for lower prices exists, especially one that disregards the interests of farmers. Noyko's efforts to forge a "community of interest" between urban residents and rural producers further undermines any chance for change in the absence of political support within the Diet for consumer interests. Rather, competing political parties attempt to outgun each other on the issue of support for farmers.

As a result of this intense concentration of decisionmaking authority, a general agreement on agricultural policy has emerged, George states. The most important facet of that agreement is a "national recognition of the need for a stable and guaranteed food supply, even at the risk of alienating consumers by high food prices, taxpayers by large budget deficits and overseas trading partners by import controls and tariff barriers." This policy process culminated in an April 1980 diet resolution which called upon the Government to "take every possible measure to enhance the country's food self-sufficiency and develop the agriculture and fishing industry with a view to ensuring the security of the people."

This food security commitment places tough obstacles in the way of foreign traders, and rightly or wrongly, justifies protectionism. As Mr. George suggests, it provides a "convenient guise of 'national interest' for special concessions to sectoral interests."

QUOTA INCREASES INSUFFICIENT

No wonder American negotiators face such obstacles in negotiating with the Japanese on the elimination of these trade barriers. At best we seem capable of eliciting from the Japanese only meager increases in quotas. That approach, however, accomplishes little.

Dr. Fred Sanderson, noted expert on Japanese food security issues and a Brookings guest scholar, challenges the Japanese approach to the goal of food security. He states:

Obviously there are better solutions than to try to grow enough food in Japan to guard against any disruptions of world trade. In any case, it's not a practical proposition. It cannot be done. The next best solution is to provide more security of supply through international agreements.

If such agreements would be consummated, what would this do to the Japanese farmer? Dr. Sanderson suggests a solution to the food security which would benefit all parties involved, the farmer as well as the American exporter and the Japanese consumer.

According to Dr. Sanderson, the distributors' profits and the Livestock Industry Promotion Corp. (LIPC) take a large share of the price markup on imported beef—causing the difference between the average $2 per pound U.S. price and the $15 per pound Japanese retail price. The LIPC is designed to channel resources to the Japanese farmer to improve meat production efficiency, but "apparently very little is actually used for this purpose." Moreover, "the system provides little incentive or pressure to improve efficiency. Rather, it creates a vested interest in inefficiency," Sanderson said.

A resolution of the import restriction-farm protection conflict, Dr. Sanderson says, would be for elimination of all quantitative restrictions on beef imports, leaving intact only the 25 percent duty. Under such a system, he projects that domestic market price would fall 50 percent, consumption increase 70 percent, and imports rise 250 percent, of which half could be expected to be supplied by U.S. farmers and ranchers who now have roughly 27 percent of the import market.

Of course, such a drastic price drop would have a devastating impact on Japanese beef producers. Deficiency payments, however, could easily remedy that problem. Sanderson notes that proceeds from the remaining 25 percent duty would cover 30 percent of the cost of the deficiency program. The remainder of the program expenditures could be financed directly by the Government or through a temporary 50 percent surcharge. Under the latter approach, Sanderson still expects prices would drop 30 percent, consumption rise 42 percent and imports climb 150 percent. Increased foreign competition would also push Japanese producers to improve the efficiency of their own operations, where much improvement is possible. Under such a system all parties, the Japanese consumer, the Japanese farmer and the American farmer, would benefit and United States-Japanese trade relations would improve markedly.

Sanderson predicts that a similar drop in orange quotas would enable both foreign and domestic producers to tap an as yet underdeveloped market for orange juice, allowing the United States to reap about half of the expected $300-$400 million sales increase. Although Japanese consumption of fresh oranges is twice that per capita as the United States, total fresh orange and orange jice consumption per capita in the United States doubles that of Japan. Japanese oranges do not produce high quality juice, thus accounting for the curreent limited market. Increased customs receipts could then be channeled into diversification of the industry.

A RESPONSIBLE SEARCH FOR SOLUTIONS NEEDED

The debate on the terrible domestic content bill should demonstrate to Japan the frustrations faced by the American public and its elected representatives regarding our bilateral trade regulations. Unless some progress occurs soon, the Japanese will be faced with stern, protectionist measures such as H.R. 5133. The international damage which that measure would cause must be avoided at all costs. But, the Japanese must step forward and make an effort to develop meaningful solutions to these conflicts.

We need to break through the wall of protectionism, not just reduce it brick by brick. Regardless of political conditions, the Japanese must assume the responsibilities of a leading world trader. They cannot continue piecemeal, grudging changes. No longer can they be allowed to drag their feet and to reject each American proposal with a "But that's not possible" response. As Dr. Fred Sanderson suggests:

" . . . I believe it is not sufficient for Japan to simply continue with the process of small increases in the import quotas. What is called for in this situation is a change in the system."

The alternative that I just suggested is but one of the many possible options which our two nations can and must explore. In the strongest possible terms I urge the development of a continuing dialogue on the matter between the Congress, the administration and the Japanese Government—one that continues unabated until these perceived inequities are removed.

The United States and Japan form one of the world's most important bilateral alliances. Intransigence on trade issues must not be allowed to destroy this key relationship. Both countries, however, must act responsibly to explore all avenues of compromise to resolve these conflicts.

It would be well to note the comments of the highly respected U.S. Ambassador to Japan, Mike Mansfield. Earlier this year he addressed the Foreign Correspondents' Club of Japan. In that speech, Mansfield warned our nations:

". . . Both of us bear a reponsibility for ensuring that the current trade problem does not reach proportions whereby it causes even more severe strains in our overall relationship. If this were to happen, it would be much more difficult for the industrial democracies to deal together with the important problems we face—problems that are crucial to world peace—problems such as Russian troops in Afghanistan, the Polish situation, the concerns for the developing countries, the global negotiations. . . ."

STATEMENT OF HON. WILLIAM S. COHEN, A U.S. SENATOR FROM THE STATE OF MAINE

Mr. Chairman, I appreciate the opportunity to submit this statement concerning U.S.-Japan bilateral trade relations. The problems are severe, and while the Administration has made considerable headway in resolving some of the issues, many more problems have yet to be resolved.

The annual U.S. trade deficit with Japan is approaching $20 billion, and a credible case can be made that the imbalance is largely the result of closed Japanese trade markets. The most visible trade problem between the U.S. and Japan concerns automobiles, where the flood of imported Japanese cars to our country has contributed to the decline of the U.S. auto industry. In many other areas, including beef, citrus products, baseball bats, tobacco products, and chocolate, the tables are turned; U.S. firms, often very competitive in international markets, are prohibited from participating in the Japanese market by stiff import quotas and other trade barriers which keep out U.S. products.

The unwillingness of the Japanese to loosen their restrictive trade practices and make their markets more accessible has produced growing sentiment in Congress to take strong action. A tide of restrictive trade-related bills was introduced in the last Congress, and that sentiment is likely to continue in this session.

I have witnessed case after case where competitive U.S. companies have tried, without success, to enter Japanese markets. A major case in point is the U.S. leather tanning industry, generally accepted as the "most competitive" of any in the world. On the other hand, the Japanese import licensing system could not be more restrictive. Only members of the Tanners' Council of Japan (TCJ) can obtain an import license for wet blue (partially processed leather) and only members of two trading associations are eligible for import licenses for leather. While the U.S. continues to honor its obligations under the bilateral agreement with Japan on leather products, it appears Japan maintains these restrictive practices. This, in my view, is a classic example of a competitive U.S. industry forced to play by a conflicting set of rules in international commerce.

Thanks to the efforts of Ambassador Brock, the Japanese government recently announced additional tariff reductions and eliminations in various product categories. I was pleased to learn that reductions in existing Japanese tariff rates were made on certain paper products, including kraft liner, kraft paper, and various types of paperboards. While the reductions were not at deep as needed, they will assist our pulp and paper industries in gaining access to the Japanese market. I am, however, very disappointed that the Japanese would not agree to further concessions in wood products such as lumber, plywood, and veneer. I hope that the Japanese government will make further concessions in the paper sector, in addition to major concessions for wood and related products.

Another example close to home involves shoes. Recently, the Acorn Products Company of Lewiston, Maine, which manufactures the "slipper socks" which were worn on two recent missions of the Space Shuttle, was in the process of arranging shipment of a major order to Japan. Unfortunately, the exporter faced the problem of obtaining a "quota" before the buyer would place the order. This is a case where a U.S. product was desired, the U.S. supplier was competitive, but a non-tariff barrier blocked the sale. Fortunately, both Ambassador Brock and Under secretary Lionel Olmer interceded in the company's behalf. Even though the technical barrier was eventually removed, the sale did not go through because of the length of time it took to get the proper clearance. It is unfortunate that companies desiring to export must rely on the availability and willingness of our top trade officials to intervene to gain access to markets. And even after such intervention, they may not be able to sell in Japanese markets.

The Footwear Industries of America (FIA) currently has a case filed under Section 301 of the Trade Act of 1974 which includes Japan. Although the U.S. Trade Representative decided not to initiate investigations concerning the petitioners' allegations of trade diversion which, in my view, is of the utmost importance in addressing the issue, the USTR did decide to initiate investigations concerning restrictive practices which cause a denial of market access. While this is a move in the right direction, it is only a first step, and I would urge that both the Ways and Means Committee and the Senate Committee on Finance closely monitor the progression of the case, particularly as it concerns Japan.

Mr. Chairman, I congratulate you for holding these hearings to examine U.S.-Japanese trade relations and I would urge you to consider the points that I have raised. In conclusion, I would like to emphasize that a fair trade policy depends on strict enforcement of our trade laws by administering agencies and strong oversight by the Congress. Without this, our international trading system, sanctioned by the General Agreement on Tariffs and Trade (GATT), will be rendered meaningless.

STATEMENT OF THE AMERICAN IRON & STEEL INSTITUTE

The American Iron and Steel Institute is pleased to present the following comments for inclusion in the record of the House Ways and Means Trade Subcommittee hearings on U.S.—Japan trade relations. The American Iron and Steel Institute is the principal trade association of the U.S. steel industry. Its membership includes 63 domestic steel companies accounting for about 90 percent of the raw steel produced in the United States.

The postwar history of the Japanese steel industry and how it came to succeed is required reading, in our view, for an understanding of the basis problem in US-Japan trade relations. The Japanese steel industry did not reach its present size and efficiency by its own efforts alone. Rather, its success was the culmination of a sustained cooperative effort among Japan's government, industry and financial institutions. This rise to dominance took place in a highly protected "green house" environment, and throughout the process the new Japanese steel industry was being heavily subsidized. In particular, the Bank of Japan played a key role in helping to fund (by guaranteeing commercial bank loans) the industry's massive investment program in which debt financing amounted to over 80 percent of total investment. U.S. companies would never be able to obtain this level of financial leverage, since they are dependent exclusively on non-governmental private capital lenders who would never finance on the basis of such a high debt-equity-ratio.

Throughout the postwar period, the steel industry in Japan was consistently singled out as a "target industry' by Japanese economic planners. It began when MITI, the Economic Planning Agency (EPA), major Japanese banks and the Japanese steel companies themselves set out in the early 1950s to create—practically speaking as a governmental plan—a successful and internationally competitive steel industry. At that time, the strategy included (1) provision of enormous capital infusions primarily in the form of debt, (2) rapidly expanding production volumes, (3) government/business cooperation to maintain high operating rates and (4) protection of the home market against imports. It was a strategy fueled and implemented, in particular, by growth in exports as the key means of production growth.

In recent years, strict controls and massive government subsidies have given way to informal "administrative guidance." Meanwhile the Japanese continued to promote aggressive counter-cyclical export programs, using export prices to regulate export volumes. And not surprisingly, the U.S. continues to be the principal export market targeted by Japan's steel producers.

To those who argue that the competitive advantages of Japanese steel results not from unfair trade practices but from the Japanese ability to produce cheaper steel, we would note the table published in a March 1982 Congressional Budget Office (CBO) study which shows that, at actual operating rate conditions in 1981, the U.S. had substantialy lower production costs that did Japan (see Table 1). This table indicates that the domestic industry is generaly competitive in its own markets with most, if not all, foreign competitors-absent unfair trade practices. In addition, the present undervaluation of the yen (which has continued to depreciate since 1981) tends to distort further Japan's competitive position in the U.S. market. Thus, in our view, lower production costs by themselves have never been sufficient to account for the success of Japan or other foreign producers in the U.S. market.

There are of course many factors affecting steel industry competitiveness. Tables 2 and 3 show that in terms of both capacity utilization and profitability, the U.S. industry has outperformed Japan's steel industry in recent years. Moreover, at actual operating rates, the U.S. and Japanese industries are almost equal in terms of labor productivity (see Table 4). Note also with respect to competitiveness that the U.S. steel industry is presently engaged in a massive self-help program designed to cut production costs and further improve overall efficiency.

Unfortunately, the lack of full and prompt trade law enforcement is threatening this program. Recent affirmative antidumping decisions on stainless clad steel plate and certain pipe and tube products have confirmed that the Japanese, with a well protected home market, have discriminated on price in the U.S. market. In addition, there have been two recent instances of customs fraud involving Japanese companies. But Japanese unfair trade practices in the U.S. market and Japanese protectionism at home have adverse economic effects on a great many U.S. industries-not just steel. These are therefore issues of common concern to all Americans.

Year after year the Congress has seen evidence that despite nearly four decades of impressive export-oriented growth, the restrictive nature of Japanese markets remains. Yet Japan would have American consumers believe that it is the injured innocent, unfairly wronged by a protectionist United States. The truth is that long before the Congress had ever heard of "reciprocity" or "local content," protectionism in Japan was an established way of life.

The Japanese offer many explanations. There are repeated calls on American exporters for more time and more understanding—of Japan's culture, its economic structure, its political system and its language. And there are the familiar exhortations that U.S. exporters must try harder, and that U.S. products must become more competitive in terms of price and quality (as if even then our products would be able to penetrate the Japanese market). But whatever the causes, the results remain the same: Japan's markets stay largely closed to U.S. manufacturers and tightly restricted against U.S. agricultural producers.

Japan, meanwhile, has invested considerable resources in fostering an image of itself as a nation of technologically advanced producers of low cost, high quality products. The other side of the Japanese economy—the gross inefficiencies in agriculture and the distribution system, and the closed market devices that keep them that way—are less well known. Likewise, few Americans understand precisely how Japan built and now maintains its "economic miracle." It is a story not of cultural peculiarities, but of very deliberate government policies and planning.

The main policy tools have been industrial targeting, subsidization and protectionism. Whether in autos and steel in the 1950's and 1960's or machine tools, computers, semiconductors and aerospace in the 1970's and 1980's, Japan's powerful Ministry of International Trade and Industry (MITI) has never hesitated to protect and subsidize its "chosen" industries. For example, at no time in the period 1950–1981 did Japan import as much as one million tons of steel. Even more startling, at no time during this period did Japan import more than 65,000 passenger cars in any one year. With a protected home market, Japanese companies have been able to build the economies of scale necessary to dominate in world markets.

The results can be seen in Japan's growing trade surplus in basic manufactures (Table 5); in the rising surplus of Japan's indirect steel trade (Table 6); in Japan's huge trade surplus in machinery and transport equipment (Table 7); and, of course, in its continued, large steel and auto trade surpluses which have received so much publicity (Tables 8 and 9). These figures show clearly that as Japan laid claim to world industrial markets, it kept its own markets closed.

In the early part of the postwar period, MITI used a combination of quotas and special legislation designed to control the use of foreign exchange and the introduction of foreign capital and technology. In 1955, when Japan joined the GATT, only 16 percent of Japanese imports were free of quotas or similar quantitative restraints. Since the mid-1960's, however, MITI and the other Japanese Ministries have relied more heavily on other means to control levels of imported goods and capital.

High tariff walls and/or quotas still restrict imports of wood, tobacco, chocolate, fisheries, beef, citrus, dairy, leather and other products, but Japan has learned that informal nontariff barriers (NTB's) can be even more effective in keeping out foreign goods. One of the most outrageous examples is the now notorious case of U.S.-made aluminum baseball bats. In order to protect the Japanese market from foreign competition, the baseball leagues in Japan have at one time or another required certifications, special design specifications, extensive testing and inspection, and a costly "S" (safety) stamp. The effect has been to bat U.S. manufacturers right out of the Japanese market.

The U.S. Government has already compiled a list of Japanese NTB's which is seventy-five pages long. Japanese Customs clearance procedures, standards, testing, labelling and certification requirements all act to inhibit U.S. imports in two specific ways—by driving up the price of U.S. products and delaying their entry into the marketplace. The case of baseball bats shows how Japan denies entry through standards based on design specifications rather than performance. But this case and the method employed is hardly unique. At the conclusion of this statement, we have included an attachment which lists just a few of the almost endless number of restrictive Japanese government policies and practices.

In recent years—and even in recent months—Japan has announced repeated moves to "liberalize" its markets for imported manufacturers and agricultural goods. Within the past year alone, Japan has announced three separate packages of trade liberalization steps, some of which *promise* to take care of the concerns which are cited in the attachment to this statement. The problem today, however, is as it has always been: implementation is always "coming soon"—but no one knows when.

Japan acts, as always, first and foremost in its own national interest. Until we see otherwise, there is little reason to believe that Japan will stop protecting its targeted industries so as to maximize production volume and economies of scale. Until proved wrong, we fear that Japan will continue to protect its declining and basic industries (including agriculture) in order to preserve domestic employment. And lacking any more compelling reasons and pressures on Japanese policy, the yen seems likely to remain significantly undervalued, so preserving Japan's export competitiveness, even at the cost of more expensive imports.

The U.S. annual trade deficit with Japan currently exceeds $20 billion. And there are predictions today of a $50 billion annual trade deficit before decade's end. In such a context, Japan's fear of "reciprocity" is understandable. But so too is America's demand for quick Japanese action. Empty gestures, we believe, will only add to bilateral trade tensions in the long-run. Japan, the country which has profited so greatly from open American markets, stands to lose a great deal.

While in Japan last winter Senator John Danforth (R-Mo) said: "I am not sure the full range of Japanese barriers to trade has ever been adequately catalogued, or that their true impact on our bilateral trade has ever been measured. What is clear is that they severely inhibit trade . . ." Senator Danforth then summed up the current mood in the United States as follows:

"Japan should understand that the United States, as well, is a great power with a proud tradition, and that we must set our own course and do what is necessary to respond when the policies of others injure our people. The time of rhetoric and bombast, so demeaning to both of our countries, should be brought to an end. The time of understanding and actions is at hand."

Indeed, there has recently appeared something of a counterpart "revisionist" perspective on Japanese industrial policy. With respect to steel and autos, for example, Japanese spokesmen admit that outright protectionism and direct subsidization existed many years ago, but they assert that these industries are now totally market oriented. What such statements never acknowledge, and what U.S. trade laws fail to counteract, is the fact that Japanese subsidies have effects in the marketplace lasting many years after the policies themselves may have formally ended.

A similar line is taken with respect to the yen. Japanese spokesmen admit that many years ago Japan had closed financial markets and tightly controlled exchange markets, but conclude that neither is true today. When recently a Japanese spokesman compared the relative openness of Japan's financial markets with those of West Germany, he neglected the comparison with Britain and the U.S. In our view the significant financial and investment barriers which remain have been a major factor in the systematic undervaluation of the yen.

Unfortunately, successive U.S. Administrations, including this one, have given conflicting signals to Japanese policy makers on how we see the US-Japan trade relationship. On February 25, 1983, regarding the American steel industry's Section 301 petition against Japan, the U.S. Trade Representative's Office concluded that Japan had entered into an agreement with the European Community, in violation of the GATT, to limit Japanese steel exports to Europe and that such an agreement could cause nullification or impairment of U.S. benefit under the GATT. At the same time, however, the USTR refused to accept the Section 301 petition for investigation.

There have also been conflicting signals with respect to the yen. Several months ago, for example, USTR made a number of statements expressing its belief that the yen was significantly undervalued. Subsequently, the Treasury Department and the Council of Economic Advisors (CEA) issued statements concluding that the yen was not undervalued.

And recently, while in one statement Commerce made the point strongly that the Japanese government had allowed a "pervasive anti-import bias" to develop in Japan, another agency, the Council of Economic Advisors, released a report which instead argued that "the main explanation of Japan's surplus in manufactures trade and in trade with the United States is that Japan, with few natural resources, incurs huge deficits in its trade in primary products, especially oil, and with primary producers especially the Organization of Petroleum Exporting Countries (OPEC)."

We are convinced that strong and consistent signals are required if the U.S.-Japan trade relationship is ever to return to one of equity. Unfortunately, our own government is partly to blame for the slow pace at which Japan moves toward this goal and for Japan's lack of understanding of U.S. resolve. When U.S. officials waiver and seem so uncertain on essential elements in the U.S.-Japan trade relationship, how can we expect quick progress toward trade that is genuinely a two-way street?

The "structural" CEA analysis of U.S.-Japan trade referred to above could easily lead to downgrading the importance of U.S. manufacturers in our overall trading relationship with Japan.

Our own quite different analysis has four basic conclusions. First, comparative advantage alone is not a sufficient explanation for the current pattern of U.S.-Japan trade. Second, Japanese protectionism, subsidization, an undervalued yen and the targeting of industries are continuing to warp the U.S.-Japan trading relationship in *all* spheres, including trade in manufactures. Third, the "structural" trade problem which exists has not arisen because of Japan's need for raw material imports (and its accompanying need to export manufactures), but because of pervasive structural unfair trade practices. And fourth, the time is long overdue for our government to develop both the will and the tools to combat these practices.

Attachments.

TABLE 1.—LANDED PRODUCTION COSTS OF SELECTED COUNTRIES AT DIFFERENT OPERATING RATES IN 1981

[In dollars per ton]

	United States	Japan	Germany	France	Great Britain
Operating at 70 percent of capacity	562	569	534	585	689
Actual conditions	553	590	544	581	706
(Operating rate)	(75.0)	(58.0)	(62.1)	(74.6)	(61.3)
Operating at 90 percent of capacity	534	508	489	545	621

Sources: Council on Wage and Price Stability, "Prices and Costs in the United States Steel Industry" (October 1977), p. 74. "Peter Marcus, The Steel Strategist No. 4" (Paine, Webber, Mitchell, and Hutchins, Inc., September 1981).

Note: Production costs include freight charges and duties to the port of entry into the United States.

TABLE 2.—CAPACITY UTILIZATION

[Net shipments as percent of reported capability]

	United States	Japan	West Germany	France	United Kingdom
1976	80.6	77.1	62.4	75.0	78.9
1977	78.6	68.4	57.3	66.5	71.2
1978	86.6	64.2	60.7	69.7	71.4
1979	87.6	67.4	66.7	71.9	74.6
1980	72.3	65.4	65.1	73.6	39.9
1981	76.8	59.6	63.1	71.5	61.9
1976–81 average	80.4	67.0	62.6	71.4	[1] 71.6

[1] Strike year of 1980 is excluded from average.

Source: World Steel Dynamics, "Steel Strategist No. 7."

TABLE 3.—FINAL PRETAX PROFIT PER TON SHIPPED

[In dollars at actual operating rates]

	United States	Japan	West Germany	France	United Kingdom
1976	2.5	−15.2	−16.1	−50.7	−31.1
1977	−5.8	−13.5	−42.2	−75.8	−47.5

TABLE 3.—FINAL PRETAX PROFIT PER TON SHIPPED—Continued

[In dollars at actual operating rates]

	United States	Japan	West Germany	France	United Kingdom
1978	27.4	9.4	−14.6	−38.3	−60.9
1979	31.5	42.9	9.4	−43.7	−44.0
1980	−16.2	21.9	−11.3	−71.9	−198.2
1981	8.0	−10.0	−44.1	−90.1	−140.0
Average	7.9	5.9	−19.8	−61.8	−87.0

Source: World Steel Dynamics, "Steel Strategist No. 6."

TABLE 4.—LABOR PRODUCTIVITY

[Manhours per net ton shipped at actual operating rates]

	United States	Japan	West Germany	France	United Kingdom
1976	8.79	10.13	11.64	14.93	19.21
1977	8.96	10.00	12.60	14.29	14.29
1978	8.15	9.57	11.69	12.65	21.61
1979	8.22	8.57	9.87	11.32	18.62
1980	8.75	8.32	10.00	10.16	[1] 37.43
1981	8.27	8.57	9.91	10.29	15.02
1982	9.10	8.54	10.91	11.14	13.67

[1] Strike year.

Source: World Steel Dynamics, "Steel Strategist No. 7."

TABLE 5.—JAPAN'S EXPORTS AND IMPORTS OF BASIC MANUFACTURES

[Value—millions of U.S. dollars]

Year	Japanese exports	Japanese imports	Japanese trade balance
1962	2,072.84	296.69	+1,776.15
1964	2,737.87	594.29	+2,143.58
1966	3,662.94	690.05	+2,972.89
1968	4,523.72	1,291.01	+3,232.71
1970	6,475.96	1,869.20	+4,606.76
1972	8,264.31	2,134.51	+6,129.80
1974	18,756.72	5,135.15	+13,621.57
1976	18,864.80	4,261.41	+14,603.39
1978	23,167.35	6,197.26	+16,970.09
1980	31,207.86	9,713.05	+21,494.81

Source: United Nations—Yearbooks of International Trade Statistics.

TABLE 6.—INDIRECT STEEL TRADE

[Thousand metric tons]

	1962	1973	1976	1979	Increase 1962–79
Japan:					
Exports	1,092	7,780	10,151	12,019	10,927
Imports	112	278	238	321	209
Balance	980	7,502	9,913	11,698	10,718
EEC:					
Exports	9,888	22,594	27,132	30,707	20,819
Imports	4,124	13,571	15,349	18,479	14,355
Balance	5,764	9,023	11,783	12,228	6,464

TABLE 6.—INDIRECT STEEL TRADE—Continued

[Thousand metric tons]

	1962	1973	1976	1979	Increase 1962-79
North America:					
Exports	1,886	3,483	5,420	5,499	3,613
Imports	1,379	5,881	5,473	7,071	5,692
Balance	507	−2,398	−53	−1,572	−2,079

Source: International Iron & Steel Institute.

TABLE 7.—JAPAN'S EXPORTS AND IMPORTS OF MACHINERY AND TRANSPORT EQUIPMENT

[Value—million U.S. dollars]

Year	Japanese exports	Japanese imports	Japanese trade balance
1962	1,252.87	770.68	+482.19
1964	1,957.97	824.66	+1,133.31
1966	3,307.71	762.98	+2,544.73
1968	4,924.81	1,266.54	+3,698.27
1970	7,833.82	2,132.41	+5,701.41
1972	13,653.75	2,376.24	+11,277.51
1974	25,235.98	4,293.01	+20,942.97
1976	35,917.19	4.082.54	+31,834.65
1978	58,168.97	5,539.07	+52,629.50
1980	75,869.97	8,389.68	+67,480.29

Source: United Nations—Yearbooks of International Trade Statistics.

TABLE 8.—JAPAN'S EXPORTS AND IMPORTS OF IRON AND STEEL

[Value—million U.S. dollars]

Year	Japanese exports	Japanese imports	Japanese trade balance
1962	531.40	112.34	+419.06
1964	909.53	176.34	+733.19
1966	1,293.19	133.16	+1,160.03
1968	1,712.61	245.87	+1,466.74
1970	2,843.93	276.14	+2,567.79
1972	3,610.31	104.28	+3,506.03
1974	10,790.26	401.29	+10,388.97
1976	10,484.74	255.82	+10,228.92
1978	11,854.77	399.09	+11,455.68
1980	15,454.25	893.85	+14,560.40

Source: United Nations—Yearbooks of International Trade Statistics.

TABLE 9.—JAPAN'S EXPORTS AND IMPORTS OF PASSENGER CARS

[Value—million U.S. dollars]

Year	Japanese exports	Japanese imports	Japanese trade balance
1962	29.69	12.63	+17.06
1964	76.91	25.78	+51.13
1966	174.74	34.33	+140.41
1968	461.97	38.03	+423.94
1970	903.42	54.12	+849.30
1972	2,235.75	80.82	+2,154.93
1974	3,500.57	198.94	+3,301.63
1976	6,055.66	222.08	+5,833.58

TABLE 9.—JAPAN'S EXPORTS AND IMPORTS OF PASSENGER CARS—Continued

[Value—million U.S. dollars]

Year	Japanese exports	Japanese imports	Japanese trade balance
1978	10,616.83	412.59	+10,204.24
1980	16,114.58	452.03	+15,662.55

Source: United Nations—Yearbooks of International Trade Statistics.

ATTACHMENT

EXAMPLES OF RESTRICTIVE JAPANESE GOVERNMENT POLICIES AND PRACTICES

Customs clearance procedures at Narita airport are reported to be the slowest of 150 countries, and one reason has been the requirement of obtaining Japanese Government agency approvals before the clearance process can begin.

Sometimes, the restrictions present some interesting Catch 22's. U.S. air conditioning equipment must be inspected at the factory—But there are not Japanese inspectors in the United States. Samples of U.S. chemicals and pharmaceuticals can't be imported without "registration approval"—but registration approval can't be obtained without analysis of the samples.

U.S. pharmaceutical, cosmetics and medical equipment firms have not been able to sell their products because of Japan's refusal to accept as valid the results of test data developed in the United States.

U.S. auto exports reportedly require six volumes of documents on standards and testing for each model and then are made subject to a discriminatory "commodity tax" which drives up the price still further. U.S. auto manufacturers have also been denied the opportunity for self-certification of compliance with Japanese standards.

U.S. corporations find that administrative guidance has seriously restricted their ability to obtain yen financing and float bonds in Japan. U.S. securities firms, until recently, could not buy seats on the Tokyo Stock Exchange.

U.S. investors have been denied the opportunity to invest in Japan's mining, petroleum, agriculture, forestry, fishery, and leather industries as well as in eleven designated firms.

Among service industries, U.S. insurance firms have complained that it's unnecessarily complex and estraordinarily time consuming to get licenses, and until recenly oly one new U.S. life insurance firm has been licensed on average each year. Meanwhile, U.S. ocean freight carriers have been prevented form engaging in affilated service industries such as trucking and warehousing.

Some U.S. high-technology firms have reported pressure to "buy" their way into the Japanese market through quid pro quos requiring technology transfers or joint venture partnerships. Imports of U.S. computer equipment have lacked financing in many cases, because they have not been accepted as collateral for securing Japanese bank loans. And U.S. high-tech demonstrator units have been denied duty-free treatment despite Japanese Customs law permitting such treatment.

Other U.S. High-tech and emerging growth industries have not been allowed to participate in MITI-sponsored R & D cooperatives, have been denied access to resulting know-how and have been unable to gain equitable access to patent rights which are controlled by MITI. In the U.S., much research is conducted through universities and is freely available to the Japanese.

U.S. tobacco exports have been kept out of 99 percent of the Japanese market by a Japanese Government monopoly which until recently has severely restricted where they can and cannot be sold. U.S. soda ash, paper and petrochemical exports have all been tightly restricted by Japanese trading companies, who in turn are the only ones permitted to import such goods.

U.S. trasportation, telecommuncations and machinery firms have all reported lack of progress in obtaining equivalent government procurement opportunities in their respective sectors. Most U.S. firms hoping to compete in Japan against MITI's chosen industries find that there remains a near monoply on government procurement in the targeted industry sectors.

CF&I Steel Corp.,
A Subsidiary of Crane Co.,
Pueblo, Colo., March 21, 1983.

Re: Japanese steel inventory buildup.

Hon. Samuel Gibbons,
Chairman, Subcommittee on Trade, House Ways and Means Committee, Rayburn House Office Building, Washington, D.C.

Dear Congressman Gibbons: CF&I Steel Corporation thanks you for the opportunity to appear before your committee on November 30, 1982 and to submit a written update and proposed amendments to the Anti-Dumping Act and the Trade Act of 1974.

We understand that you and the Subcommittee members will be visiting trade officials in Japan later this week. CF&I would greatly appreciate it if you could bring to the attention of the Japanese the $1,300,000,000 inventory of oil country tubular steel which the Japanese stored all over the Gulf Coast U.S. during 1982.

As I testified before the Subcommittee, the large majority of the Japanese steel inventory has not been purchased by the U.S. holders, but has been imported on a free consignment or sale-or-return basis.

The distributors and Japanese trading companies have already offered this inventory at a 50 percent discount. If the Japanese inventory, a five-month's supply, is sold at half price, it will cost thousands of U.S. jobs in Ohio, Texas, Oklahoma, Arkansas and Kansas where these steel products are manufactured. Some of these manufacturers may not be able to stay in business at all.

We think the Japanese should make prompt and full disclosure regarding the importing and subsidizing of this tubular steel inventory. We also think this inventory should be withdrawn immediately to Japan.

Thank you for any help you can give our industry.

Very truly yours,

T. P. McGrann,
Vice President, Commercial.

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A Subsidiary of Crane Co.,
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The distributors and Japanese trading companies have already offered this inventory at a 50 percent discount. If the Japanese inventory, a five-month's supply, is sold at half price, it will cost thousands of U.S. jobs in Ohio, Texas, Oklahoma, Arkansas and Kansas where these steel products are manufactured. Some of these manufacturers may not be able to stay in business at all.

Please ask the Japanese not to sell this steel below fair value to monopolize the U.S. market.

Thank you for any help you can give our industry.

Very truly yours,

Edward L. Overtree,
General Counsel and Corporate Secretary.

STATEMENT OF THOMAS P. MCGRANN, VICE PRESIDENT—COMMERCIAL, CF&I STEEL CORP., PUEBLO, COLO.

I testified before, and submitted a statement to, this subcommittee on November 30, 1982 in regard to the inventory build-up and overhang of Japanese oil country tubular goods in the United States. I simply want the Chairman and Subcommittee to know that the problem I described on November 30 still exists. Japanese trading companies and their distributors and consignees still have an inventory of about 1 million tons of Japanese oil country tubular goods in storage. As I stated on November 30, CF&I believes that this inventory will continue to be offered and eventually sold at dumped prices. CF&I also continues to believe that the financing costs for this inventory, which are now well over $100,000,000, have been subsidized in some way by the Japanese government.

Finally, we believe that the Japanese steel producers have built up and are holding this inventory because they know that the yen is about to appreciate. CF&I continues to believe that the Japanese steel producers can be sure what is going to happen to the yen, because the Japanese government controls the value of the yen through its controls on the import and export of both merchandise and capital.

CF&I has identified three amendments that are needed to the Anti-Dumping Act of 1921 and the countervailing duties section of the Tariff Act of 1930, neither of which presently provides for adequate relief from inventory accumulation, government-subsidized financing of inventory and government control of currency exchange rates. Attached to this Statement is a text of the amendments needed, with an explanation of the purpose of each amendment.

Thank you very much for this opportunity to submit a Statement on behalf of CF&I.

CF&I STEEL CORP.,
A SUBSIDIARY OF CRANE CO.,
March 17, 1983.

To: Hon. Sam Gibbons, Chairman, Subcommittee on Trade, Ways and Means, Committee, House of Representatives.
From: E. L. Overtree.
Subject: Amendments to the Anti-Dumping Act of 1921 (19 U.S.C. § 160–171) and the Countervailing Duty Section of the Tariff Act of 1930 (19 U.S.C. § 1303).

The Japanese have found and used certain deficiencies in the above statutes by shipping 1 million tons of oil country tubular goods (approximate value $1,300,000,000) during 1982 without having any buyers. By building up such a huge advance inventory, the Japanese can dump enough steel when drilling recovers to put all their competitors out of business. Once the sales have been made, proof of dumping will exist; by then, however, there will be no petitioners left in business to bring the Petition.

Therefore, the loopholes need to be closed by the following amendments:

Add a sentence to the end of 19 U.S.C. § 163 as follows:

"When imported merchandise enters the United States before it is sold or agreed to be sold, the exporter's sale price shall be zero or the price at which bona fide offers to sell are made in the United States, and no proof of sale or agreement to sell is necessary for a determination under section 201 of this title that the imported merchandise is being, or is likely to be, sold in the United States at less than its fair value."

One of the means by which the Japanese steel industry is able to build such a huge inventory is the subsidization of financing costs by the Japanese government and the government-controlled Japanese banking system. In the case of Japanese oil country tubular goods, the financing costs have exceeded $100,000,000 since January 1, 1982. However, the secretiveness of the Japanese government and the Japanese banks makes it impossible for injured parties to prove the existence of the financing subsidy, especially since the fact-finding body specified by the statute, the International Trade Commission, requires that the petitioner sustain the burden of proving the existence of the subsidy. Therefore, the burden of proof should be shifted to the non-U.S. exporters where the petitioner can prove an inventory build-up, the lack of demand to support the build-up and the absence of any reasonable explanation for the expense of financing the inventory. 19 U.S.C. § 1303 should be amended to add a new subsection (a)(7) to read as follows:

"Evidence of an inventory build-up in the United States of any article or merchandise manufactured or produced outside the United States, when accompanied by evidence of the lack of demand for such article or merchandise, and unless justified by some reasonable explanation, shall constitute prima facie proof of the existence of a bounty or grant by the government of the country of production, and the foreign exporters of such article or merchandise shall have the burden of proving that the inventory build-up has not been caused nor aided by the government of the country of production."

The reason that the Japanese steel industry has built up this huge inventory of oil country tubular goods is that they have information that the Japanese government plans to ease the restrictions on the yen and thereby allow it to appreciate, making Japanese goods less price competitive. In order to anticipate this decrease in competitiveness, the Japanese steel industry manufactured the goods and built up the inventory in the United States ahead of the known yen appreciation. Thus the Japanese steel mills can compete during less favorable 1983 exchange rates by using goods produced during the period of more favorable exchange rates in 1982. Foreign governments' manipulation of currency exchange rates should also be deemed a subsidization unless proven otherwise, because it is impossible for an injured party to obtain the secret evidence of the manipulation. 19 U.S.C. § 1303 should be amended to add an additional subsection (a)(8) as follows:

"Changes in the exchange rate between the U.S. dollar and the currency of any other country, to the extent not justified to maintain parity between national price levels, shall constitute prima facie evidence of a bounty or grant within the meaning of this section and the foreign exporter of any article or merchandise manufactured or produced in such country shall have the burden of proving that such difference has not been caused nor aided by the government of the country of production."

E. L. OVERTREE.

CF&I STEEL CORP.,
A SUBSIDIARY OF CRANE CO.,
March 17, 1983.

To: Pat Brown, Office of Hon. Ray Kogovsek.
From: E. L. Overtree.
Subject: Amendments to the Anti-Dumping Act of 1921 (19 U.S.C. § 160-171) and the Countervailing Duty Section of the Tariff Act of 1930 (19 U.S.C. § 1303).

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E. L. Overtree.

CF&I Steel Corp.,
A Subsidiary of Crane Co.,
March 17, 1983.

To: Mr. Joseph Schinosi, Executive Office of President, U.S. Trade Representative, Washington, D.C.
From: E. L. Overtree.
Subject: Amendments to the Anti-Dumping Act of 1921 (19 U.S.C. § 160–171) and the Countervailing Duty Section of the Tariff Act of 1930 (19 U.S.C. § 1303).

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E. L. OVERTREE.

STATEMENT OF CARL W. EK, LEGISLATIVE ASSISTANT, NATIONAL FARMERS UNION

The National Farmers Union appreciates this opportunity to present in written form its views on U.S.-Japanese trade relations. We commend the Chairman and members of the Subcommittee on the timeliness of these hearings. They provide an excellent forum which allows both public and governmental witnesses to express their concerns over this important issue. These hearings should thereby serve as an excellent backdrop for the upcoming Williamsburg Economic Summit.

The United States and Japan have long maintained an extensive trading relationship with one another. This trade is noteworthy for its diversity, encompassing as it does everything from soybeans to sporting goods to silicon chips. Remarkable, too, by any standards, are the value and volume of this trade: combined exports between the two countries approached $60 billion last year. But it is the balance of this trade, heavily skewed toward Japan, which is of intense concern to American business and political leaders.

Agriculture stands apart as one of the few economic sectors in which the United States experienced a trade surplus with Japan. Japan is approximately 1/25 the size of the United States—about the size of California—and supports a relatively large population of 117 million. Arable land is quite limited; indeed, more acres are harvested in the United States for Japanese consumers than in all of Japan itself. All of these factors, along with some which will be discussed below, combined to make Japan a net importer of agricultural products. Even though food self sufficiency has been an official governmental goal for decades, the Japanese need to import 45 percent of their food. Of that amount, 39 percent is purchased from the United States. Japan has been our largest single country market for agricultural products since 1964.

In light of the fact that Japan constitutes 15 percent ot the total export market for American agricultural commodities, it is both curious and disturbing that so much attention is focused upon Japan's quantitative restrictions on two farm commodities: beef and citrus.

In order to understand the reasons for the quotas on these commodities, it is helpful to review the history of post-war Japanese agricultural policy. Widespread starvation conditions which prevailed in Japan both during and immediately after the Second World War led to the development of an agricultural policy which aimed for self sufficiency in food production. Also, an opportunity was afforded to radically alter the structure of Japanese farming. What had once been an almost feudal system, dominated by absentee landlords, was changed during the occupation to allow tenants to own the land which they had cultivated. This massive land reform also served the purpose of easing high post-war unemployment.

The islands' rapid reindustrialization gave rise to a migration to urban areas, but, perhaps the distances are so much smaller, many Japanese farmers were able to remain on their land and commute to their off-farm jobs. In addition, government policy was able to provide the Japanese farmer with an income on a par with his urban cousin. This forestalled the type of mass exodus which occurred in the United States during the last half century.

The consequence of all this was the creation and perpetuation of a system of agriculture which is inefficient by American standards. The average farm size in Japan is 2.9 acres, as compared to 431 acres in the United States. Understandably, Japanese farmers earn an average of 80 percent of their income off-farm. The large number of Japanese producers (6 million last year, compared to 2.4 million in the United States), their disproportionate representation in the Diet, and their strong support of the Liberal Democratic Party, which has ruled the country since 1955, make the Japanese farmer a powerful political force. The Japanese public seems not to resent the financial support accorded to farmers. Many older Japanese still have strong memories of their country's critical food shortage during the war, and the widespread rationing which followed. Also, despite heavy subsidization of food production, the Japanese spend only 21 percent of their income on food, which compared quite favorably to most other developed nations.

The National Famers Union believes that a further escalation of rhetoric over the beef and citrus issue is a high-risk, low-win game. By demanding that Japan purchase more of its beef and citrus abroad, the United States is demanding of Japanese political leaders not only that they ignore a powerful constituency, but also that thay attempt to quickly reverse a long-standing and widely accepted policy of food security. Further aggravation over this issue may induce the Japanese to respond in the same manner in which they reacted to the imposition of a soybean embargo by the United States in 1973. The Japanese diversified their source of supply, and Brazil became a major beneficiary. It would be but a short step for the Japanese to begin buying beef from Australia and Agrentina.

The potential gain in expanded export sales to Japan is hardly warranted. The Japanese already account for 60 percent and 40 percent of our export market in beef and citrus, respectively. Moreover, economists at the USDA's Economic Research Service have estimated that, with complete liberalization of Japanese import policies, the United States would only be able to sell an additional $300 to $350 million worth of beef and citrus products to Japan. With annual export sales averaging $6 billion for the last two years, this means that the United States would be able to increase its overall agricultural exports to Japan by a mere 5 percent. It would also cause our feed grains exports to fall off somewhat.

It is frequently stated in the Western media that the beef and citrus quotas are a symbol of Japanese protection of its own inefficient industries. We are concerned lest American agriculture once again becomes a victim of foreign policy symbolism. Administration officials never cease in pointing out the damage wrought by the 1980 embargo of grain to the Soviet Union, yet they persist in risking a similar market loss vis-a-vis Japan.

As a general approach toward improving trade relations with Japan and other commercial partners around the world as well, the National Farmers Union urges the Administration to work closely with the other conferees at the upcoming Williamsburg Economic Summit conference so that international exchange rates will more accurately reflect the value of their underlying currencies.

Exchange rate distortions are especially acute in the case of Japan and the United States. A great deal of the misalignment in capital markets may be attributed to the restrictive American monetary policy and loose fiscal policy which have combined to drive up interest rates to record levels. This, in turn, caused a heavy flow of foreign investment capital which pumped up the value of the dollar. Even though American agricultural commodities have suffered depressed prices, the strength of the dollar relative to other major currencies has actually made our corn, wheat, and soybeans more expensive to foreign customers. The Japanese, on the other hand, have maintained artifically low domestic interest rates by insulating themselves from world credit markets. This has resulted in a grossly undervalued yen which makes Japan's goods ever more competitive internationally.

We therefore urge the Congress to continue its work to bring down the federal deficit which has proved so damaging to our economic performance and our worldwide trade position. And we further urge the Administration to address the issue of liberalized Japanese capital markets this month in Williamsburg.

Finally, we would urge the Administration to explore certain innovative approaches to the U.S.-Japan trade problem which have been developed. Two in particular are worthy of consideration.

Dr. Fred Sanderson of the Brookings Institution has developed a proposal which would allow the Japanese to ease trade tensions while continuing to assist their livestock sector. This could be achieved, he suggests, through a combined policy of eliminating Japanese beef quotas while maintaining the present duty, perhaps supplementing it with a levy. The lifting of quantitative restrictions would permit the importation of more beef—some of which would be supplied by the U.S. This would have the effect of increasing the supply and decreasing the cost of beef to the Japanese consumer. With domestic prices more nearly in line with world market prices, Japanese cattlemen would feel competitive pressure to improve their productivity. The revenues from increased duties could be used to provide deficiency payments to Japanese livestock producers to cushion them against the sudden drop in prices and to provide them with time to improve the efficiency of their operations.

Another, more ambitious plan has been put forward by Dr. Emery Castle of Resources for the Future as part of a joint effort with Japanese economists and policymakers. Their approach calls for a re-examination which stresses the most basic issues and areas of agreement. Among the fundamental realities are the need for agriculture and trade, and the strength of agriculture in Japan and the U.S.—both economically and politically. With these points in mind, government representatives should move to develop consensus on specific bilateral needs. Dr. Castle and his colleagues suggest the following:

Increase commitments to agricultural research and education; improve stability in world food markets through, for example, the development of buffer stocks; work to resist protectionism as a general policy; alter domestic agricultural policies to reflect new international trading roles; and negotiate on a regular basis, with special emphasis placed upon prior consultation on trade policy announcements, assurances of supply reliability, and agreement upon mutual economic goals.

Mr. Chairman, we again thank you for allowing us to include our recommendations on this issue, and hope that you and the members of your panel will not hesitate to contact us if you have any questions.

National Forest
Products Association

John V. Ward
Director, International Trade

Forest Industries Building • 1619 Massachusetts Avenue, N.W.
Washington, D.C. 20036 • 202/797-5817

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Ways and Means
Subcommittee on Trade

March 8, 1983

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The Honorable Sam M. Gibbons
House Office Building
Washington, DC 20515

Dear Chairman Gibbons:

The National Forest Products Association is a federation of 29 forest industry associations, representing nationally over 2000 companies involved in the production and marketing, both domestically and internationally, of a wide variety of wood products. NFPA is pleased that the Ways and Means Trade Subcommittee will be conducting hearings on access to the Japanese market and following up with a review trip to Japan itself.

We urge the Subcommittee to consider American wood products as a major sector which could benefit enormously by increased market access to Japan, specifically through its reduced tariffs on our products. We hope this letter and its attachments could be made part of the hearing records. To that end, we are attaching a Summary and complete white paper entitled "Reduced Japanese Trade Barriers to Wood Products: A Billion Dollar Potential."

Our industry, through a cooperative effort coordinated by NFPA and working with the US Trade Representative's Office, the Foreign Agricultural Service, and other government agencies has targeted reducing high Japanese tariffs on veneer, softwood plywood, particleboard and certain species of softwood lumber as its major international trade goal for 1983.

Japan is not now a small market for the wood products industry; it has been shipping $1.5-2.0 billion annually in mainly logs, chips, and lumber to that country. Nor are the Japanese tariffs on finished wood products illegal.

However these tariffs, particularly the 12-15 percent rates on wood panel products, virtually preclude their entry into the Japanese market. The US government and the industry have been urging Japan to eliminate or sharply reduce these finished wood products tariffs for the past two years. Even though important benefits could accrue to both countries if such action was taken, Japan has not responded.

We hope the Subcommittee will view the wood products tariff issue as positive opportunity for both countries. Moreover, we urge you to raise this issue with the Japanese during your visit.

Thank you for your consideration.

Sincerely,

John V Ward

John V. Ward

cc Members, Ways and Means Subcommittee on International Trade
The Honorable William E. Brock
The Honorable John R. Block
The Honorable Malcolm Baldrige
The Honorable George Shultz

Enclosures

JVW/mro

February 1, 1983

SUMMARY

REDUCING JAPAN'S TRADE BARRIERS TO WOOD PRODUCTS: A BILLION DOLLAR POTENTIAL

Japan offers the greatest opportunity in the world for increased U.S. exports of wood products. U.S. industry, which now exports $1.5-2.0 billion annually to Japan, believes these exports can be expanded by $1.0 billion[2] by 1990.

Japanese Tariff Reduction

Although U.S. industry must aggressively promote and adapt to the requirements of the Japanese market to attain this potential, the primary impetus to increased U.S. exports would be a reduction in high Japanese tariffs[3] to wood products, e.g. on:

● Plywood	15-20%
● Softwood and hardwood veneer	15%
● Particleboard	12-13%
● Spruce, pine, and fir species of lumber	6-10%

Wood products are one of the four major sectors targeted by the Office of the U.S. Trade Representative for Japanese duty reduction. However, in spite of repeated requests from both the U.S. industry and government, Japan has not been willing to eliminate or reduce those tariffs.

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[1] This memorandum is a SUMMARY, emphasizing tariff reduction, of a detailed analysis with the same title, discussing the Japanese market potential for the U.S. wood products industry. For a copy of the detailed analysis, contact the National Forest Products Association, 1619 Massachusetts Avenue, N.W., Washington, D.C. 20036; tel: (202) 797-5820; telex: 89489 ALPA WSH.

[2] Approximately $500 million of this amount would be due to tariff elimination. See Table 1 for detailed export potential

[3] A Japanese standard on softwood plywood still is a trade barrier to U.S. wood products. However, negotiations in the last two years have resolved all problems but one, and an acceptable standard is nearing resolution. A cartel of lumber importers and sawmillers also could potentially be restrictive. However, there is no evidence that such will be implemented or, if it is, that it will be trade restrictive.

Benefits to United States and Japan

U.S. industry believes such duty adjustments would not only open up the Japanese market to U.S. producers, but that they could be accomplished with minimal disruptive effect on Japan's industry and, in certain cases, with considerable benefit.

Reducing tariffs on spruce, pine and fir lumber certainly would have minimal detrimental effect. Japan has no tariffs on any other softwood lumber products. And, these species serve almost the same applications. One caveat, the elimination of those duties on lumber might help Canada or some other supplying nations more than the United States. Nonetheless, with Japan's enormous deficit in wood, these duties seem incongruous except as a remnant of protectionism.

Eliminating duties on softwood plywood would seem, at least on the surface, to impact the domestic Japanese plywood industry. The long term potential for increased U.S. plywood exports would be substantial, however, U.S. production currently is entirely committed to a 4' x 8' size multiple, whereas Japan requires a 3' x 6' multiple. U.S. industry must make major investments to produce 3' x 6' sheets of plywood. Thus, a significant time period would elapse before Japan would experience any major competition from the United States. And, as the second largest plywood industry in the world, exporting 25 times as much to the United States as the United States exports to Japan, it should be able to absorb this competition.

Eliminating duties on veneer would appear to be in the direct interest of the Japanese plywood industry. Japanese plywood manufacturers recently have found U.S. softwood veneer to be a positive addition to their panel products, previously made entirely of hardwood veneer, both from a manufacturing and a structural standpoint. Furthermore, Japanese producers are facing major supply constraints, since their primary suppliers of hardwood logs and veneer in Southeast Asia are gradually restricting their exports of these products.

Reducing Japanese duties on particleboard would only affect a small industry in Japan. Moreover, this industry is facing sharply increasing costs for its raw material, domestic and imported wood chips and residues. A reduction in particleboard tariffs would be of major benefit to end users of this product in Japan.

Overall Benefits to Japan

Finally, eliminating or significantly reducing wood products duties would provide overall benefits to Japan. This action would assist Japan in meeting its commitment to the U.S. government and the wood products industry that its imports will include increasing quantities of finished U.S. wood products. Such action would help defuse political arguments by some groups in the United States which intermittently try to further restrict the exports of logs, presently the major item of wood trade between these two countries.

Moreover, such positive action would strengthen the U.S. wood products industry's support for other Japanese trading objectives in the United States, support at present which is non-existent because of Japanese non-response to U.S. requests for wood tariff reductions.

Summary

In summary, eliminating Japanese tariffs on wood products --plywood, veneer, particleboard, and spruce, pine, and fir species of lumber--would benefit both nations. It should continue to be a major objective of U.S. trade policy negotiations between these two countries.

National Forest Products Association
1619 Massachusetts Avenue, NW
Washington, DC 20036
202-797-5895

Table 1

Japanese Market for Selected Wood Products
U.S. Participation and Potential*

	1980-81 Actual						1990 Forecast	
roduct	Estimated Total Japanese Consumption-1980 ($ mill.)	Total Japanese Imports in 1980 ($ mill.)	U.S. Exports ($ mill.) 1980	1981	U.S. Market Share of Imports in 1980 (%)	Possible Total Japanese Imports in 1990 ($ mill.)[2]	Possible U.S. Exports in 1990 ($ mill.)	U.S. Market Share of Imports in 1990 (%)
oftwood Logs	5,405	2,727	1,291.0	823.0	47.3	3,000	1,400	46.7
oftwood Lumber	7,546	1,038	221.0	176.0	21.3	1,600	700	43.8
lywood[1]	6,000	33	2.0	2.0	6.1	600	100	16.7
eneer (total)	N. A.	25	0.6	0.4	2.4	300	100	33.3
Softwood	N. A.	N. A.	0.2	0.1	N. A.	220	80	36.3
Hardwood	N. A.	N. A.	0.4	0.3	N. A.	80	20	25.0
articleboard	200	14	5.0	2.0	35.7	50	30	60.0
ardwood Logs	3,577	2,968	10.0	9.0	0.3	1,800	50	2.8
ardwood Lumber	2,447	188	9.0	12.0	4.7	400	50	12.5
ulpwood & Chips	1,767	1,041	359.0	235.0	34.4	1,300	500	38.5
Totals	26,942	8,034[3]	1,897.6	1,259.4	23.6	9,050	2,930	33.5

Sources: United Nations Food and Agriculture Organization for Japanese statistics;
U.S. Department of Commerce for U.S. statistics; NFPA for 1990 estimates.
Japanese plywood figures are for both hardwood (now almost entirely) and softwood plywood.
In 1980 dollars.
In 1980 Japan imported approximately 30% of its domestic consumption for all major products.

February 1, 1983

REDUCING JAPAN'S TRADE BARRIERS TO WOOD PRODUCTS:

A BILLION DOLLAR POTENTIAL

Japan offers the greatest opportunity for increased U.S. wood products exports of any nation in the world--*if* that country can be persuaded to reduce its trade barriers.

U.S. industry, which now exports $1.5-$2.0 billion annually to Japan, believes its shipments can be increased by at least $1.0 billion* over the next 10 years, if Japan will:

- Reduce its tariffs,
- Modify its standards,
- And otherwise encourage imports of finished wood products.

Of course, American industry must pursue this market aggressively, by both adapting to Japanese sizes, quality requirements and other market needs, while at the same time promoting U.S. product sizes and construction methods. However, for most U.S. products, particularly wood panels, elimination or reduction in the trade barriers is a required first step.

The Japanese import more wood than any other single product except for food and oil. Moreover, their wood from the Far East supply regions currently is being gradually restricted. Hence, a reduction in Japanese tariff and non-tariff trade barriers on wood products would be directly in the country's own self-interest.

This memorandum outlines:

- The problem, i.e. the trade barriers involved.
- The opportunity--why and how can the United States increase its exports to Japan?
- The specific products affected.
- A recommended course of action

Each of these areas is dealt with in its own section.

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* An estimated $500 million of this potential would be influenced by reductions in tariffs and modifications in standards alone.

This paper has been prepared by the International Trade Division of the National Forest Products Association, 1619 Massachusetts Ave., N.W., Washington, D.C. 20036, U.S.A.; telephone (202) 797-5820; telex 89489 ALPA WSH.

THE PROBLEMS

U.S. industry is the major supplier of wood products to Japan. (See Table 1 on page 3, showing import share by supplying country.) Moreover, trends favor increased U.S. exports of finished or semi-finished products.

Yet, in spite of major efforts by the U.S. industry and government in the last two years, the Japanese:

- Maintain prohibitively high tariffs on certain species of softwood lumber and panel products, specifically:

- Softwood plywood (44.15.191, -.111, -.199, -.300)	15-20%
- Softwood and hardwood veneer (44.14.230 and 44.14.290)	15%
- Particleboard (44.18.100 and 44.18.200)	12%-13%
- Spruce/pine/fir species of lumber (44.05.300 and 44.13.309)	6-10%

- Maintain a production specification which effectively precludes a large segment of western U.S. softwood plywood products.
- Continue to move very slowly in changing the form of wood imports from softwood logs to finished products.
- Have proposed establishing a cartel for softwood lumber imports.

Japan must eliminate these barriers if the United States is to successfully realize the full potential of its market.

THE OPPORTUNITY

The Japanese opportunity is clear. This country is the world's second largest wood importer. Its needs, particularly for finished products, should continue to grow. And the United States should become increasingly competitive.

Although Japan currently is in the economic doldrums--its housing market is at its lowest point in years and exchange rates have made competition difficult for U.S. suppliers--the long-term potential is very favorable.

Table 1

Japanese Imports from Major Supply Sources
1980

Originating Country	Softwood Logs	Softwood Lumber	Veneer	Hardwood Logs	Hardwood Lumber	Plywood	Pulpwood and Chips
U.S.A.	57.6%	33.3%	3.3%	-----	-----	4.3%	36.6%
Canada	2.6%	55.1%	1.6%	-----	-----	15.3%	5.2%
U.S.S.R.	34.4%	3.0%	-----	-----	-----	0.1%	2.4%
Malaysia	-----	-----	25.1%	42.7%	21.4%	10.3%	2.0%
Indonesia	-----	-----	25.0%	45.4%	13.6%	17.3%	0.8%
Philippines	-----	-----	17.3%	5.9%	20.8%	0.3%	-----
New Zealand	4.5%	7.3%	-----	-----	-----	0.1%	2.4%
Other	0.9%	1.3%	27.7%	6.0%	44.2%	52.2%	50.6%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Imports (000)	17,889m^3	4,652m^3	27,616m^2	19,622m^3	926m^3	15,060m^2	10,009bdt

m^3 = cubic meters
m^2 = square meters
bdt = bone dry ton
Source: Japan Lumber Journal

Japanese current (1980) imports of primary wood products total more than $8.0 billion. Although Japan is expected to become somewhat more self-sufficient by 1990, its imports in current dollars should increase by at least $1.0 billion.

The U.S. market share for all imported products in 1980 was 24%, a figure which is high because of a 58% share of the Japanese softwood log import market. By 1990 the United States could make major gains in products other than logs. For example:

- U.S. softwood lumber might increase its market share from 21% to 44%, with an increase of $500 million in exports estimated.
- U.S. softwood plywood exports could grow from less than $2 million to as much as $100 million.
- Veneer would experience massive growth. Exports could increase from almost nothing today to a total of $100 million--$80 million in softwood veneer and $20 million in hardwood veneer.
- Particleboard might expand sixfold to $30 million.
- And other products, e.g. hardwood logs and lumber, pulpwood and chips, might grow apace.

The specifics of this potential are shown in Table 2, "The Japanese Market for Selected Wood Products: U.S. Participation and Potential," on page 6.

Why Does This Opportunity Exist?

There are several broad trends that influence this opportunity: U.S. western producers' needs, internal trends in Japan and changes caused by Japan's hardwood log sources.

First, U.S. western producers of softwood lumber and plywood are annually becoming less competitive in U.S. eastern and midwestern markets, as well as in the European export market, mainly because of transportation costs. For example, western lumber's share of the U.S. northeastern market dropped from 60% to 18% between 1960 and 1980, and the estimated western share* of U.S. plywood exports, almost entirely to Europe, dropped from 94% to 66% between 1978 and 1981.

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* Estimated western share is defined as all softwood plywood which is not faced with southern pine veneer.

Second, over the last 20 years the Japanese have become increasingly dependent on wood products imports. In 1980 Japan imported approximately 30% of its total consumption of major wood products. (See Table 2.) Although Japan may become more self-sufficient in about 15-20 years, its total volume of wood imports still is expected to increase.

Most of Japan's present imports are in log form--hardwood logs from Southeast Asia and softwood logs, primarily from the United States and the USSR, with some supplies from Chile, New Zealand and Canada. These logs are converted to lumber and plywood by some 25,000 sawmills and plywood mills throughout the country.

Japan's lumber and plywood manufacturing industries now provide the vast bulk of the product for domestic consumption. However, many mills are increasingly becoming less competitive. Ten years ago, Japan exported 322,000m^3 in plywood; that figure dropped to 48,000m^3 by 1980. The number of plywood and sawmills operated in Japan dropped by 36% and 10% respectively during the same 10-year period. And during the current housing dip in Japan, the rate of bankruptcies and business closings has increased.

On top of these problems, Japan is facing a major constriction in supply from its Southeast Asian shippers. Indonesia, Malaysia and the Philippines all have announced, and are enforcing, a gradual restraint on their exports of logs. This action is being taken to force production and exports of value added products such as lumber and plywood. For example, the Indonesian government, whose forest supplied 47% of Japan's hardwood logs in 1980, announced a total phaseout of log exports by 1985. Indonesia hopes to supplant log exports with plywood and lumber exports, for which it now is dramatically expanding its capacity.

These countries' log restrictions and planned production increases are having a major effect on trade throughout Asia. The greatest impact, however, will be on Japan, the largest log buyer in the world. The effect has been muted to date because the constraints are occurring during a period of economic recession in Japan. However, when that country's housing market returns to normal, the effect will be substantial.

The net results--of U.S. western needs, of strong Japanese demand, of increasing Japanese domestic competitiveness and of a disrupted and changing raw material supply--could mean great potential for U.S. exports of logs, lumber, plywood, veneer and other products. But what and how much actually will be sold is highly dependent on resolving the trade barrier issues for each product.

Table 2

Japanese Market for Selected Wood Products
U.S. Participation and Potential*

	1980-81 Actual						1990 Forecast	
roduct	Estimated Total Japanese Consump-tion-1980 ($ mill.)	Total Japanese Imports in 1980 ($ mill.)	U.S. Exports ($ mill.) 1980	1981	U.S. Market Share of Imports in 1980 (%)	Possible Total Japanese Imports in 1990 ($ mill.)[2]	Possible U.S. Exports in 1990 ($ mill.)	U.S. Market Share of Imports in 1990 (%)
oftwood Logs	5,405	2,727	1,291.0	823.0	47.3	3,000	1,400	46.7
oftwood Lumber	7,546	1,038	221.0	176.0	21.3	1,600	700	43.8
lywood[1]	6,000	33	2.0	2.0	6.1	600	100	16.7
eneer (total)	N. A.	25	0.6	0.4	2.4	300	100	33.3
Softwood	N. A.	N. A.	0.2	0.1	N. A.	220	80	36.3
Hardwood	N. A.	N. A.	0.4	0.3	N. A.	80	20	25.0
rticleboard	200	14	5.0	2.0	35.7	50	30	60.0
rdwood Logs	3,577	2,968	10.0	9.0	0.3	1,800	50	2.8
rdwood Lumber	2,447	188	9.0	12.0	4.7	400	50	12.5
lpwood & Chips	1,767	1,041	359.0	235.0	34.4	1,300	500	38.5
Totals	26,942	8,034[3]	1,897.6	1,259.4	23.6	9,050	2,930	33.5

Sources: United Nations Food and Agriculture Organization for Japanese statistics;
U.S. Department of Commerce for U.S. statistics; NFPA for 1990 estimates.
Japanese plywood figures are for both hardwood (now almost entirely) and softwood plywood.
In 1980 dollars.
In 1980 Japan imported approximately 30% of its domestic consumption for all major products.

THE PRODUCTS

Softwood Logs and Lumber

Softwood logs and lumber are the most important U.S. exports to Japan, accounting for about 80% of U.S. wood exports--$1.3 billion in logs and $221 million in lumber in 1980; moreover, they are inextricably linked.

Although log shipments have fallen off since 1979-80, given a renewed Japanese housing market--1.4 million more or less versus today's 1.0 million housing starts--they could return to former levels.

But, the United States wants to sell more softwood lumber (and other finished products)--as well as logs --to Japan because of the increased value added to the product. Many companies in the industry also recognize that increased exports of lumber, plywood, veneer and other semifinished products would help reduce pressure from U.S. environmentalists and others who would like to put certain restrictions on the log trade.

The problems in Japan which seem to impede growth of U.S. lumber exports are:

- The continued maintenance in Japan of a large sawmilling industry composed of thousands of small companies. Recent action to establish a Japanese lumber importing cartel could exacerbate this problem.
- A propensity by the Japanese to purchase more lumber from Canada--which by law discourages log exports--rather than from the United States.
- Continued maintenance of a 6-10% tariff against certain species of softwood lumber.

On the U.S. side, a lack of knowledge about the Japanese market, a lack of "fit" of Japanese sizes with those of the United States and simply an absence of commitment to export impedes U.S. penetration. However, these shortcomings are being overcome by U.S. western producers' growing recognition that their market growth potential lies overseas.

One factor that has been working to change both American and Japanese attitudes has been establishment of the U.S./Japan Lumber

Promotion Committee consisting of industry representatives from both countries, including both sawmill and log importing interests from the Japanese side. This group held two meetings in 1981--one in the United States and one in Japan. Although results were not dramatic,

- The Japanese sawmilling industry--which previously had resisted increased lumber imports--publicly acknowledged imports' eventual desirability.
- Greater understanding has been developed by the Japanese of U.S. supply problems and by the United States of Japanese market needs.
- Certain ongoing procedures have been put in place, including greater industry exchange of information and supply and purchasing prospect publicity.

Because of overriding economic problems in both Japan and the United States since 1981, this committee has not met recently. However, it will meet on request from either country's members.

Another vehicle for discussion has been the U.S./Japan Forest Products Committee, a government-to-government group with industry participation. It was established during the Multilateral Trade Negotiations and now meets annually. It deals not only with lumber and logs but with all wood product issues. Unfortunately, until the January 1983 meeting the Japanese refused to use this committee to discuss tariff issues.

The Japanese government says that it is taking action to reduce inefficient lumber and plywood operations. However, it seems to continue to support an obsolete portion of the industry, an action which conflicts with that country's espoused emphasis on industries which have a growing comparative advantage worldwide.

Reports of Japanese industry moves, encouraged by the government, to establish a lumber import cartel--albeit one whose avowed motives are merely to provide improved trade data--raise further questions as to the real motives of the Japanese.

Japanese lumber purchases from Canada--a sore point with the United States--reportedly are being made because of better prices (in part at least influenced by exchange rates) and a greater commitment by Canadian industry to meet Japanese market needs and requirements. Although very important, this situation is unrelated to Japan's trade barriers and thus not germane to this paper.

The Lumber Tariff   Japanese tariffs of 6-10% on spruce, pine and true fir species of lumber are a deterrent to increased trade in these species. (Table 3 on page 10 outlines this tariff and the U.S. species it affects.)

Japan agreed during the MTN to reduce its tariff for rough lumber under category 44.05 for these three species groups from 10% in 1979 to 6% by 1987. However, Japan would not agree to reduce its tariffs on surfaced or planed lumber in these species; thus, they remain at 10%.

Although the balance of U.S. lumber exports enter Japan duty free, both the rough and surfaced lumber tariffs present obstacles to producers in the inland areas of the Pacific Northwest and, less importantly, to the U.S. South and Northeast.

Unfortunately, the reduction of the duties on spruce, pine, and fir lumber would probably bring greater benefits to American competitors, particularly Canada, but also the Soviet Union, Chile, and New Zealand. Nonetheless with Japan's enormous deficit in wood, these duties seem incongruous except as a remnant of protectionism.

Softwood Plywood

American softwood plywood* has important potential in Japan. However, it must overcome two obstacles--Japanese standards and a 15-20% tariff. As an indication of the effect of these barriers, in 1981 the United States shipped $1.8 million in plywood to Japan, the second largest consumer of plywood in the world. At the same time, the United States shipped $20 million in plywood to Denmark, $32 million to Belgium and $30 million to the United Kingdom.

The first problem--Japanese plywood standards which effectively precluded softwood plywood use for construction--has been modified but not overcome. In the Tokyo Round of the MTN, Japan committed

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* The United States also produces hardwood plywood, primarily for decorative applications. However, this product is not competitive outside the United States.

Table 3

U. S. SPECIES
WHICH JAPANESE LUMBER DUTIES AFFECT

Japanese Tariff Codes:	1982 Tariff	1987 Tariff
• 44.05.300 Lumber-rough (see species below) not more than 160 mm (6.3 inches) thick.	9%	6%
• 44.13.300 Lumber-finished (see species below) not more than 160 mm (6.3 inches) thick.	10%	10%

All softwood lumber of other sizes and species is admitted duty free.

Species affected by tariffs.

Sugar Pine	(Pinus lambertiana)
Ponderosa Pine	(Pinus ponderosa)
Lodgepole Pine	(Pinus contorta)
Idaho White Pine	(Pinus monticola)
Longleaf Pine	(Pinus palustris)
Shortleaf Pine	(Pinus echinata)
Loblolly Pine	(Pinus taeda)
Slash Pine	(Pinus elliotti)
Jack Pine	(Pinus resinosa)
Eastern White Pine	(Pinus strobus)
Balsam Fir	(Abies balsamea)
Subalpine Fir	(Abies lasiocarpa)
White Fir	(Abies concolor)

(All other true firs are permitted free entry)

Engelmann Spruce	(Picea engelmannii)
Western White Spruce	(Picea glauca)
Sitka Spruce	(Picea sitchensis)
Red Spruce	(Picea rubens)
Larch	(Larix occidentalis)

to resolving the differences between their standard and that of the United States by 1980. However, it was not until the end of that year, and after great pressure from the U.S. government, that Japan would even come to the table to discuss the issue. After two years and much effort by the American Plywood Association and the U.S. government, all issues except one have been resolved. Japan currently is filing its new standard with the General Agreement on Tariffs and Trade and it is expected that U.S. softwood plywood may be accepted for construction applications in Japan early 1983.

The one issue, a tolerance for "white spec" or "white pocket" --those remnant effects of a fungus which occur in old growth Douglas fir--has never been acceptable to Japan. Since a large amount of western plywood is produced from Douglas fir, this is a problem for the United States. U.S. tests prove white spec in the amounts permitted in construction grade plywood has no effect on the usefulness of the product. APA technical management is making some progress in gaining Japanese acceptance of the U.S. position

The Plywood Tariff Problem. While some progress has been made on the standards issue, a major problem still remains--that of a high tariff wall for softwood plywood.

Japan made no reductions during the MTN in its 15% tariff for sheathing and sanded grades of plywood under tariff 44.15.191. Japanese negotiators did agree to reduce the 20% tariff on specialty plywood (44.15.111 and .119) to 15% over a span of three years beginning in 1984. The result is that U.S. producers will still face a 15% duty which, since it is applied on a CIF basis, raises the cost to the consumer even higher.

In contrast, the United States agreed during the MTN to reduce its tariff on hardwood plywood (produced by Japan and other Pacific Rim countries) from 20% to 8% in equal stages between 1980 and 1984. Between 1979-81, Japan shipped an average of $53 million in hardwood plywood to the United States, or 26 times U.S. shipments of softwood plywood to Japan.

Japan's plywood producers are not eager to see their protective tariff come down. The industry has been in a major recession in recent years, with each year many producers going out of business. The government is providing some assistance to these companies and the industry is maintaining a cartel to govern production and, to some degree, pricing.

Japan's plywood industry has not only been concerned with competition from North America's softwood plywood. It also has viewed the plywood tariff as protection against Southeast Asian plywood producers, in Korea and Taiwan and soon to be in Indonesia and Malaysia. Although reportedly many of the new mills being built in Indonesia are for the U.S./European size of 4' x 8', the long range potential for competition in the 3' x 6' Japanese size still is there.

Realistically, any tariff solution benefitting U.S. producers must consider Japanese concern for this Asian competition. One possibility might be to get Japan to reduce only the tariff on softwood plywood.

The Size Problem. Even with standards resolution and duty reduction, the U.S. producer still faces a Japanese customer use requirement for primarily 3' x 6' panels, as opposed to the U.S. norm of 4' x 8'. Certainly Asian plywood capacity will influence Japanese interest in the 4' x 8' panel. And some small progress has been made in converting Japanese demand to the larger panel size, mainly for timber frame or North American style home construction, now accounting for 2% of total Japanese construction. But the 3' x 6' module, standard for construction, concrete forming and other Japanese uses of plywood, remains a major obstacle for U.S. producers to overcome. And, the production changes necessary to meet this requirement are costly and almost prohibitive on existing equipment.

Until action has been taken to reduce the high duties on plywood, it will be most difficult for U.S. producers to deal effectively with the size issue.

Softwood and Hardwood Veneer

The potential is high for increased U.S. shipments of both softwood and hardwood veneer to Japan.

The primary obstacle to U.S. veneer exports to Japan is a 15% tariff under 44.14.230 and .290--the same for both hardwood and softwood veneer. (Japan does provide a preferential 7.5% tariff on veneer from less developed countries.) Japan made no reductions in its veneer tariffs during the Tokyo Round of the MTN. In contrast, during the MTN and subsequent to it, the United States reduced all its tariffs on a variety of veneer items to zero.

In 1980, Japan imported a total of $25 million in veneer. U.S. shipments have averaged about $500,000 in the last few years, and are expected to increase. Japan's plywood industry, faced with restrictions on the supply of hardwood logs and veneer from Southeast Asia, can use softwood veneer, particularly in high-performance applications where strength is important.

Japanese producers recently have been experimenting with softwood, mainly for inner plies of hardwood-faced plywood. Softwood veneer offers some advantages in the production process (superior strength, lower drying and glue costs and improved recovery). If the tests are successful and the economics favorable, a major shift to partial use of softwood veneer could provide an excellent opportunity for U.S. producers to export softwood veneer to Japan. Additional or modified facilities to meet this demand might be required.

Tariff reduction is therefore essential to U.S. manufacturers having the ability to produce softwood veneer if they are to (1) make the capital investments necessary to pursue this market aggressively, (2) improve their competitive position relative to the domestically produced hardwood veneer, and (3) penetrate the market rapidly enough to discourage Japanese producers from (under the protection of the veneer tariff) converting their own hardwood veneer capacity to produce softwood veneer.

U.S. hardwood veneer also offers good potential, especially in the context of the potential future restrictions on Southeast Asian supply. One producer estimates that the elimination of the 15% duty would allow shipments to be increased from presently under $300,000 to more than $20 million annually.

The U.S. hardwood veneer industry, although small, is highly competitive worldwide for decorative veneers, mainly for furniture. About 40% of its production is exported, almost all of which now is going to Europe where the United States has a substantial market share. Japan's Southeast Asian supply problem, to the degree it affects species used for decorative purposes, could also benefit U.S. hardwood veneer manufacturers. Japan, which is just starting to develop an important furniture industry as its homes become more Westernized in decor, offers a growing opportunity to U.S. producers.

In summary, a reduction in veneer tariffs for both hardwood and softwood is in the interest of the Japanese plywood industry and that of their potential U.S. suppliers.

Particleboard and Other Panel Products

U.S. particleboard, mainly from the U.S. West Coast, should be able to compete favorably in Japan if the present duty of 13.1% (under 44.18.100), which declines to 12% by 1987, could be sharply reduced. (U.S. duties on particleboard will be 4% in 1987)

U.S. producers shipped $2 million in particleboard to Japan in 1981, a figure which it is believed could be substantially increased.

The United States now ships huge volumes--an average of $300 million in the last three years--in wood chips and residues for pulp, particleboard and other products to be made in Japan. These shipments may well grow in the future as Japan buys more finished wood products and as its own wood residues are reduced due to cutbacks in Southeast Asian log supplies. A portion of this residue product from the U.S. West could well be shipped to Japan as densified, compacted particleboard products.

The Japanese particleboard industry is small but growing. It would appear that this industry's growth may be stifled by the increase in costs of imported and domestically generated wood residue.

For American producers of particleboard, the standard Japanese size of 3' x 6' may be somewhat of a problem since U.S. sizes, like plywood, are 4' x 8'. However, because of the equipment used in U.S. particleboard production, the Japanese-sized module is much less an obstacle to market penetration compared to that of plywood.

Moreover, particleboard in Japan is produced in 3' x 6' sizes because this is the common size for which the cutting equipment of furniture manufacturers is designed. Small adaptations of both American manufacturers and Japanese users of the product could allow full acceptance of the U.S. product.

U.S. manufacturers could also be providing other panel products to Japan--particleboard cores for blockboards, multiply softwood plywood platforms for hardwood veneer faces, oriented strandboard and waferboard for structural applications.

However, each of these products faces the 12-13% tariff problems previously outlined. And any dimensional differences, either on particleboard or these products, cannot be resolved until a reduced duty makes the United States more competitive.

Other Products

As shown in Table 2, the other major products shipped to Japan by the United States are pulpwood, hardwood lumber and hardwood logs.

Pulpwood and chips face no tariff or other trade barriers. Their growth will be purely a function of growth in demand by the Japanese pulp industry and other users.

Similarly, U.S. hardwood log and lumber products face no trade barriers. Moreover, the Southeast Asian log restrictions could potentially benefit U.S. hardwood producers.

However, since little or no promotion has been undertaken by U.S. companies, most of which are small, an acceptance problem for U.S. species--either as logs or lumber--does exist. A beginning effort, at first exploratory, currently is being undertaken by the industry in an attempt to determine how to overcome this obstacle. In any case, the problems are promotional, not trade barrier related.

RECOMMENDATIONS FOR ACTION

Reducing Japanese trade barriers to U.S. wood products should be a top priority of the U.S. government and industry.

- The United States holds important comparative advantages.
- Japanese potential exists for a billion dollar increase in exports over the next 10 years.
- Japan is undergoing a major structural supply shift which could benefit U.S. producers if properly addressed.

Furthermore, Japan is under great pressure to open its markets wider to U.S. goods. Concessions in wood might be made by that country more easily than for many other products. And Japan could accordingly reap the benefits of strengthened political support for its imports into the United States by a major sector of U.S. industry--forest products.

Therefore, industry recommends that the U.S. government, to effectively aid increases in exports to Japan, should:

1. Keep wood products at the very highest priority in all trade talks with Japan.

2. Press hard for the elimination of, or a major reduction in, wood products tariffs for panel products, specifically:

   - Softwood plywood
   - Softwood and hardwood veneer
   - Particleboard and other panel products

   Indicate that a reduction in lumber tariffs would be consistent with other Japanes measures to open its markets, but that such action would not be a major benefit to the United States.

3. Keep the pressure on for increased U.S. lumber exports:

   - In bilateral talks, particularly at high levels.
   - Through the U.S./Japan Forest Products Committee.
   - By supporting the U.S./Japan Lumber Promotion Committee's efforts.
   - By opposing establishment of a Japanese cartel which might restrict Japan's lumber imports.
   - By encouraging Japan to implement measures which will help phase down its sawmilling and plywood industries.
   - By supporting an expansion of U.S. industry lumber promotion in Japan.

4. Push for final resolution on plywood standards, particularly the white spec issue.

A U.S. industry program, aimed at reducing Japanese tariffs by 1984 has been prepared and will be coordinated with U.S. government activities.

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James P. Gregory
Senior Vice President
Administration and
Secretary

March 15, 1983

Mr. John J. Salmon
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
Room 1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Salmon:

While the issue of U.S.-Japan trade relations is of vital importance to the United States, it is critical to high technology industries. Perkin-Elmer's annual sales of $1 billion are derived mainly from high technology products and 44 percent of those sales are made outside of the United States. Our core businesses are related to computer science. We make the machines that produce semiconductor devices, we manufacture 32-bit minicomputers and software systems, and we produce computerized laboratory analytical instruments used in analytical chemistry.

We are staunch supporters of international trade. However, as the Trade Subcommittee heard from Perkin-Elmer last year, there is a real and present danger that the U.S. semiconductor industry, for example, will lose its world leadership and a substantial share of its home market to its Japanese counterpart in the next few years.

The seriousness of this threat to U.S. economic well being can only be understood when we contemplate the effect such a loss would have on the computer industry, the telecommunications industry, and a host of smaller industries ranging from scientific instruments to television games. In short, a myriad of industries we call "electronics." All of these industries are built upon the same foundation of technology, the modern semiconductor.

That this danger is real and present has been illustrated by the entry of Japanese companies into the U.S. market for semiconductor memories, and their capture of more than 70 percent of the 64K RAM market within 18 months of shipping their first product.

In computers, for example, the Japanese Government has set out to win a 30 percent share of the worldwide market for mainframe computers by 1990. The powerful Ministry of Trade and Industry (MITI) is sponsoring the aggressive development of a fifth-generation, super computer.

Japan's phenomenally rapid progress in high technology has been helped by efficient intelligence gathering. U.S. companies frequently find their products copied before they have an opportunity to exploit their sales potential. The Japan External Trade Organization (Jetro) maintains 80 offices around the world for gathering business and technology data. It serves as a central clearing agency that disseminates industry-wide data together with digests of related foreign technical publications. As a result, Japan can frequently circumvent costly product development and rarely enters a new market until it is first tested by U.S. firms. The U.S. has no organization as effective in market research or technology tracking. The technology Japanese companies cannot develop or acquire, they buy or license.

We believe that the Federal Government has to help solve U.S.-Japan trade problems. A major reason why Japan has emerged as an economic power is the active involvement and support of the Japanese Government. Only recently has our Government acknowledged the great cultural difference between U.S. and Japanese business-government relations. The difference has worked to great advantage for Japanese business, and to the disadvantage of the U.S. economy. As you travel through Japan, you will see evidence of this difference. We think it will demonstrate the scope of our problem and lead to the conclusion that the United States government and business must cooperate.

There is an $18 billion a year trade imbalance between Japan and the U.S. and this imbalance is wiping out major segments of the U.S. economy. The situation worsens every year. The imbalance must be returned to reasonable boundaries and kept there, otherwise such trade cannot continue.

Trade problems should be solved like business problems, that is, by establishing goals and then managing toward those goals. Instead of squabbling about GATT violations, subsidies, dumping, and non-tariff barriers, we should be negotiating with the Japanese about acceptable goals in the volume and balance of our trade together. We should be working to increase, not decrease, the volume of trade, but we must find a more effective means of assuring a reasonable balance of trade.

We suggest that we establish with the Japanese an expansionist trade program, with explicit goals for the volume and balance of trade. The goals should be set so as to require the commitment of both governments to cooperate with their own industries on the import, as well as the export, components of that trade. We should use the expansionist character of the trading relationship to narrow the deficit.

We must give some attention to industry sector goals and performance, but the sectors cannot be independent of over-all trade performance any more than those sectors are independent of their home economy. Any effective management system has to have considerable give and take. What we are seeking is not protectionism, but a balanced, fair, and expansionist trade relationship with Japan. The alternative is no trade with Japan.

We cannot continue having our industries overrun one at a time. As with Japanese agriculture, the social cost is simply too high.

We must also deal immediately with Japanese government targeting practices. A program that should prove effective has been suggested by the Semiconductor Industry

Association. It calls upon our government to:

1. Announce, as U.S. policy, that foreign industrial targeting practices will not be allowed to undermine U.S. technological and economic leadership in this critical industrial sector.
2. Identify, analyze and counter the distorting effects of foreign industrial targeting practices.
3. Insist that U.S. semiconductor firms receive commercial opportunities in Japan that are fully equivalent to those enjoyed by Japanese firms.
4. Promptly seek enforcement of Japan's obligations through consultations and other procedures available under GATT, and the Subsidies Code.

We need legislation that will empower our President to limit access to the U.S. market on the part of trading partners with whom we cannot establish equitable trading relationships. Such powers ought to be granted by Congress in the context of free trade and expansionist goals. We want the Japanese, as well as our other trading partners, to feel that we wish to continue to do business together. However, it must also be understood that we cannot continue as in the past. If our economies are to expand together, we must start managing for results.

Thank you for the opportunity to provide the Subcommittee with Perkin-Elmer's viewpoint on U.S.-Japan trade relations. We would appreciate receiving a response to our views on U.S.-Japan bilateral trade issues subsequent to the return of the Trade Mission to the U.S.

Sincerely,

James P. Gregory

JPG:cew

cc: The Honorable Christopher Dodd
The Honorable Lowell Weicker, Jr.

STATEMENT OF DAVID J. STEINBERG, PRESIDENT, U.S. COUNCIL FOR AN OPEN WORLD ECONOMY, INC.

(The U.S. Council for an Open World Economy is a private, nonprofit, public-interest organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any private interest.)

The United States—its government, business and labor communities, and all who are interested in American economic growth, open international commerce, sound international development and the enlightened self-interest of the nation—should press for progressively freer U.S. access to the Japanese economy in the context of a multilateral effort to remove international trade barriers (unjustifiable commercial and investment obstructions of all kinds), particularly in the world's most advanced countries. Japan is much more "protectionist" than a country so economically advanced has any reasonable basis for being. Japan should in fact be playing a leadership role in seeking a more open world economy. With astute strategy and proper tactics, there is reason for optimism about the prospects for expanding foreign access to the Japanese market. However, the strategy and tactics needed for substantial success in this endeavor are not yet in place.

Although current efforts at securing greater U.S. access to the Japanese market (aside from bilateral "reciprocity" ploys and other counterproductive tactics) are suitable as short-run devices, the prospects for wide, deep and sustained liberalization of Japanese impediments against U.S. goods, services and investment are greatly restricted by lack of a coherent, comprehensive, convincing strategy for progressively and consistently freer trade (ultimately free trade) between Japan and the United States—within the framework of a comparable strategy affecting U.S. commerce with the world economy as a whole. Such a strategy would call for the United States to invite all the industrialized countries to join with us in forming a free trade area under the General Agreement on Tariffs and Trade, with the clear implication (which no knowledegeable government could fail to understand) that those countries that did not join would be denied the special treatment accorded one another by those that did participate. (The world's developing countries would be given special privileges in this free trade area and be required to assume special responsibilities consonant with their economic capabilities.) Each participating country would be impelled to have a domestic adjustment and redevelopment policy to backstop its commitment to the rules and timetable of the free-trade charter. Such a domestic strategy is essential to making the free-trade policy politically palatable. In our case, what is good for the nation as a whole must be made good for every state in the Union.

A definitive, explicitly free-trade strategy, involving far-reaching commitments not only by Japan but by the United States and as many other advanced countries as agreed to participate, would conceivably engender impressive reforms in Japanese attitudes toward the world economy and toward Japan's role and responsibilities in the world economy. Anything significantly short of the free-and-fair-trade charter which I have advocated in many forums would leave Japan in its present state of profound uncertainty over what the United States and other advanced countries may have in store for Japanese exports as international competition gains in intensity. This uncertainty and concurrent feelings of national insecurity may have contributed significantly to Japan's reluctance to be more forthcoming in reducing barriers against foreign goods, services and capital. Substantial reform of the domestic cultural and political obstacles retarding adoption of more-open policies in relations with the world economy will require a much more dynamic, more far-reaching trade initiative than the United States or virtually its entire "liberal trade" community has thus far advocated.

Obviously, such a policy initiative will take time to "sell" to Congress and the American people, and time to persuade Japan and our other trading partners even to consider. Thus, our Council is not advocating it as an alternative, but as a longer-range supplement, to the conventional tactics now pursued in seeking freer access to the Japanese market. However, we should have no illusions about the prospects for substantially and continuously freer access to the Japanese economy through the kinds of pressures and threats that for too long have characterized U.S. approaches to Japanese authorities on trade issues. Japan is much more likely to move impressively toward open trade with the world within the framework of a charter in which all participating countries make corresponding commitments to open international commerce than in response to the kinds of overtures the United States and other advanced countries have been orchestrating. I invite those who find "reciprocity" to be an appealing standard for trade-policy formation to ponder the fact that the policy strategy I am advocating projects the ultimate in progressive reciprocity—the programmed removal of all foreign-economic obstructions by those countries with the economic capabilities to go this route.

STATEMENT OF THE UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

The rapid expansion of exports by industries targeted for support by the Japanese government presents the most challenging issue facing our trade policy today. The trade problem is rooted in the dichotomy of the Japanese economy. The Japanese government has overseen the expansion of a narrow, technologically advanced export sector while virtually all other sectors continue to have low productivity. Because this dichotomy will persist for some time to come, we cannot expect the recurring problem of battered and displaced U.S. industries to be relieved by changes in the exchange rate or tax policy in the next several years. U.S. trade policy for autos should constitute a critical part of an industrial policy that can, among other things, counteract the harm arising from Japanese targeting.

The success of the Japanese economy in the last three decades has no parallel in economic history for a country of its size. Between 1950 and 1981, the Japanese Gross Domestic Product (GDP) in real terms grew at an average annual rate of 7.9 percent compared with the U.S. rate of 3.4 percent and the German rate of 5.2. During that same time, Japanese exports grew at an even faster rate. While Japanese exports have been crucial to the success of the Japanese economy, they still make up only 13.4 percent of Japan's GDP. Thus, it is important to note that Japan's phenomenal growth has primarily been built around a rapidly expanding internal market.

JAPAN'S UNEVEN ECONOMY AS THE SOURCE OF ITS EXPORT INDUSTRIES' SUCCESS

We have all become familiar with Japan's successful export industries, particularly in durable goods manufacturing such as autos, steel, and electronics. In these stellar industries the technology in Japan matches the best anywhere else in the world. But these familiar industries are not representative of the Japanese economy as a whole. Their agriculture, service sector, and even much of manufacturing remain relatively little touched by modern technology. As a result, taken as a whole, the Japanese economy is far less productive than our own.

We can verify Japan's lower overall productivity by comparing our two countries' gross domestic product (GDP) per worker, a rough indicator of a nation's productivity across-the-board. In 1981, Japan's GDP per worker amounted to 72.6 percent of the U.S. level. (Actual productivity per hour would be even lower because the Japanese probably average at least 10 percent more hours per worker per year.) This wide gap between U.S. and Japanese productivity has been rapidly narrowing. This Japanese percentage rose from a mere 6.7 percent in 1950 to 13.7 percent in 1960 and to 33.7 percent in 1970. As these figures indicate, Japan represents the most advanced of the "newly industrializing countries" (NICs) of the post-war era.

With a less productive overall economy than our own, virtually everyone in Japan gets lower pay than their American counterpart. That applies to executives, engineers, teachers, production workers, etc. For example, the Wall Street Journal of January 5, 1983, reported that U.S. engineers bring down $2,000 to $2,800 a month after a year's experience but new engineers for Sony and Matsushita receive $1,100 a month including benefits. Likewise, the Bureau of Labor Statistics has calculated for 1982 that the average labor cost for production workers in Japanese manufacturing was only 49 percent of that for American manufacturing.

In the jargon of trade theory, a nation's industry has "comparative advantage" when it stands out from other industries in that country. In other words, the key comparison in "comparative advantage" is made within a country, not with competitive industries in other countries. With such low productivity in so many other sectors, a Japanese industry does not need to attain an absolute advantage over a foreign industry to enjoy an enormous "comparative advantage." By obtaining technolgy merely on a par with a U.S. industry, a Japanese industry automatically has a wide "comparative advantage" over industries in the U.S. where our industries have more consistently high productivity across industries.

Critics of specific U.S. industries that are being displaced by a Japanese industry often ask rhetorically "when will that industry ever catch up with the Japanese industry?" In fact, the more appropriate question for the foreseeable future is "when will the rest of the Japanese economy catch up with the rest of the U.S. economy?" Until then, the U.S. industry can be on a par with the Japanese but steadily lose the competition. The auto industry is just one case in point. Last year the Japan Productivity Center estimated that in 1980 (when Japanese production enjoyed full capacity utilization and U.S. was depressed) the productivity of the Japanese industry stood just 1 percent above the U.S. industry.

WHAT MAKES JAPAN SO DIFFERENT?

Of course, many countries have substantially lower overall productivity and pay scales than the U.S., but they have caused us less concern. What makes Japan different? Japan stands out because of (1) its ability to install the world's most advanced technology in those industries where it puts its attention and (2) its large domestic market.

The Japanese economy has a corps of engineers, applied scientists and entrepreneurs that is the envy of other countries with hopes of emulation such as Brazil, Korea, India, etc. With government direction and assistance, this corps has scoured the world for the best technology, negotiated for its sale, improved on it, and installed production facilities of the necessary scale in a series of successful export industries. Not only the NICs, but the countries of Europe, the U.S. and Canada can take lessons from Japan in the commercialization of technology.

The large size of the Japanese domestic market has been crucial both for Japanese success on the one hand and for the problems we have faced on the other hand. The government has helped targeted industries expand with trade restrictions, access to preferential credit, leverage in bargaining and transfer of foreign technology, subsidies in obtaining new production equipment, etc. Such measures have been used for the steel, auto, machine tool industries in the past and for the producer electronics and aerospace industries today. The large internal market permits a sheltered home market to enjoy competition between several Japanese firms each producing a large scale. Thus, once targeted industry ventures into export markets beyond its sheltered home market, it has substantial production experience and the cost advantages of large scale production.

LACK OF OPENNESS OF THE JAPANESE ECONOMY

The Japanese economy can be very open to imports—when they help or do not harm a domestic Japanese industry. Thus, it favors imports of raw timber but not lumber, iron ore but not steel, etc. On the other hand, when the Japanese government wants to manage the expansion or retreat of an industry, it does not tolerate unfettered free trade. Not allowing free trade dogma to interfere with domestic economic objectives is neither "fair" or "unfair" but sensible policy.

Japan's large net exports in manufactures per se do not indicate a lack of openness of the Japanese market. Japan has few natural resources and little arable land in relation to its population. As shown in Appendix 1, Japan had a deficit of $107 billion in primary products in 1981. It compensates for such large deficits in resources and food with large surpluses in manufactured goods.

For statistical evidence of Japan's lack of openness, we must look at its manufactured imports, particularly the broad category of machinery and equipment (e.g., cars, planes, computers, electrical and electronic equipment, scientific instruments, machine tools, including parts). In 1981, Japan imported $11 billion worth of machinery and equipment (labelled "engineering products" in Appendices 1, 2, and 3) compared to exports of $104 billion. Japan's natural endowments help account for Japan's net manufacturing surplus of $93 billion, but a ratio of exports to imports of ten to one is not mandated by nature. Japan's automotive exports to the U.S. alone ($13 billion in 1981 and 1982) exceed all its imports of machinery and equipment from the entire world.

In contrast, the U.S. had net exports of $24 billion in machinery and equipment made up of $105 billion in exports and $81 billion in imports for an export to import ratio of 1.3 to 1 (Appendix 2). In its trade with the rest of the world, the European Community had net exports of $66 billion in this category, with exports of $135 billion and imports of $68 billion, a ratio of 2 to 1 (Appendix 3).

The situation is even more stark when we examine trade with developing countries. Japan is near some of the most competitive of those countries: South Korea, Taiwan, Hong Kong, and Singapore. Thus, transportation cost should make those countries more competitive in Japan than the U.S. or EC. However, Japan's imports of machinery and equipment from all non-oil developing countries amounted to only $1.47 billion, but it had exports of 17 times as much—$25 billion—back to those countries. On the other hand, the U.S. exported only twice as much as it imported from those countries ($29 billion versus $14 billion). Put another way, the U.S. imported ten times as much machinery and equipment from non-oil developing countries as did Japan. (The EC once again fell in between with exports five times imports ($32 billion versus $6 billion). Such discrepancies led Taiwan, with machinery and equipment exports of $311 million to Japan but imports of $2.542 billion, in February 1982 to ban imports of 1,553 different products from Japan, including electronic applicances and vehicles.

THE MYTH OF THE "SELF-MADE" JAPANESE AUTO INDUSTRY

There has been a widespread myth perpetuated by some at your March 10 hearings, that a fledgling Japanese auto industry has burst on the world scene in recent years despite the best efforts of MITI. In fact, the Japanese auto industry was the second largest in the world by 1967 (See Appendix 4). Moreover, as in other industries, the Japanese government—and MITI in particular—has played a key role, both in launching the auto industry as an international competitor and in providing strategic support in later years. With few variations, the pattern closely resembles the set of measures MITI has been using more recently to lauch the semi-conductor/computer and aerospace industries.

It is important to put into perspective the achievements and alleged failures of the Japanese industrial policy for auto. The Japanese industry grew from second place with 3 million vehicles in 1967 to first place with 11 million vehicles by 1980. Stiff tariff barriers to auto imports were maintained until the early 1970's, well after Japan had become the world's second largest producer. Onerous standards, customs procedures, and other non-tariff barriers to imported vehicles still remain today. Under government guidance, the auto companies were granted access to preferential credit. This was most crucial to near-bankrupt Toyo Kogyo in the mid-1970's, but according to Toyo Kogyo, such credit help merely followed precedents set for Toyota and Nissan. In addition, the auto industry was an intentional beneficiary of other MITI policies to improve technology and reduce costs for the steel, robotics, and machine tool industries. Finally, until the eary 1970's the government prevented foreign investment in Japan's auto market which had become the second largest in the world by 1964 (Appendix 5). The policy changes in the early 1970's to permit minority holdings.

The often alleged MITI "failure" in auto does not withstand close scrutiny. As Japan approached becoming the world's second largest auto producer in the mid-1960's, no Japanese company produced more than a million vehicles (Appendix 6). Because scale economies are so important for competitive export of vehicles, MITI had visions of just two companies each producing several million vehicles. Hence, MITI attempted to consolidate a dozen different Japanese auto companies into two large companies centered around Toyota and Nissan. Although MITI failed at consolidation, the fundamental MITI vision has been fulfilled on schedule: Toyota and Nissan (with its keiretsu partner Fuji, maker of Subarus) have each produced over 3 million vehicles in recent years. But now three other companeis, Toyo Kogy, Mitsubishi, and Honda also produce over a million vehicles, too. In fact, five of the top twelve companies in the world today are Japanese (Appendix 7). That hardly represents "failure" for an auto industrial policy that was always more concerned with increasing the number of cars produced than decreasing the number of companies producing them.

MITI's continuing efforts in support of the auto industry are further exemplified by its creamic engine project. According to the Oriental Economist (Appendix 8, page 4), MITI has combined the technical forces of several Japanese companies to overcome the perceived lead in engine technology held by the U.S. industry.

THE INADEQUATE U.S. AUTO TRADE POLICY

The U.S. response to Japanese auto exports has differed markedly from that of the major European vehicle producers. Germany, France, Italy, the U.K. and Sweden have stabilized Japanese penetration of their national markets at 10, 2.5, 0.1, 11, and 15 percent respectively—far less than the 23 percent penetration the U.S. now experiences (Appendix 9). In fact, Japan exported only 851,536 vehicles to the vehicle market of the European Community in 1981, just 40 percent of the 2,304,814 vehicles sent to the U.S., despite the fact that the EC's vehicle market was larger than the U.S. market—particularly for smaller vehicles.

The increase in the Japanese share of the U.S. auto market from 11 percent in 1978 to 21 percent in 1982 significantly aggravated an already serious loss of employment here. That additional 10 percent share represented 1.05 million of 1982's sales, equivalent to 20.6 percent of the total sales decline of 5.1 million for domestic vehicles. Since more than a million jobs have been lost in producing vehicles, the higher Japanese share accounts for over two hundred thousand lost jobs. We reject the logic of the free trade sooth-sayers (and U.S. import relief law) that would have us ignore those two hundred thousand lost jobs because we have lost more jobs for other reasons.

Over the last several years of friction over auto trade, Japan has made noise about redressing imbalances, but done little. An editor of the Japan Economic Journal has aptly described the Japanese strategy in trade negotiations with the U.S.: "making easy promises and postponing real action almost indefinitely." [1] The U.S., on the other hand, tends to ignore trade problems until domestic distress gets unbearable.

As our auto deficits with Japan have mushroomed ($38 billion over the last three years), the Japanese have sponsored dozens of meaningless study teams and issued countless press releases, each promising a more balanced relationship in automotive trade and investment. In 1980, the Japanese vehicle companies conducted a much ballyhooed "parts buying mission" to reduce tensions caused by our then $1.3 billion auto parts deficit with Japan. At its conclusion, the spokesperson for the mission assured the American public that the Japanese auto companies would probably buy $300 million worth of U.S. auto parts in 1981. U.S. Commerce Department data indicate that our 1981 exports of auto parts to Japan amounted to $119 million, little more than the $105 million for 1980 once inflation is taken into account. Last year was not better as exports amounted to only $128 million. Between 1980 and 1982, however, our auto parts imports from Japan soared to $1,822 million, causing the parts deficit to widen by another $424 million.

There have been some positive developments in the auto situation with Japan. Toyota, with its recently concluded joint venture with General Motors, has become the last of the three Japanese auto companies with the largest sales here to invest here. Honda has recently begun car assembly in Ohio and Nissan plans to launch truck production in Tennessee this summer. These are welcome first steps by the Japanese companies. However, even when all three have begun production, American production of parts and assembly will constitute less than ten percent of value of Japanese companies' vehicles sold here. In addition, since 1981 the Japanese government has announced annual commitments to limit shipments of cars to the U.S. to 1.68 million. The Japanese share of the domestic car market has nonetheless continued to rise because of the depressed U.S. market. For an industry with lead times of several years, such tenuous annual commitments do not provide a basis for sound planning for the U.S. industry. For that reason, we support domestic auto content legislation discussed below.

AEROSPACE: JAPAN'S PURSUIT OF TECHNOLOGY BY CONTROLLING MARKET ACCESS

In recent years, MITI has renewed efforts to become a world competitor in the aerospace industry, an industry which the U.S. now excels. MITI projects a 30 percent world market share by the year 2010. As a major purchaser of aerospace equipment, Japan has used the leverage of its purchases to learn the technology and to gain production experience for its long term plans. The activities of three Japanese companies (Fuji, Kawasaki, and Mitsubishi) have been coordinated to develop the industry's international competitiveness in coming years.

When the Japanese government made multi-billion dollar purchases of F-15s from McDonnell Douglas and P3Cs from Lockheed, it required an average of 40 percent or more of their total value to be produced in Japan. Japanese content in the initial deliveries was to start low and rise gradually. Over the several years of deliveries, the Japanese companies will acquire enough technology to be producing most of the planes. The Japanese government is willing to pay a substantial (though possibly cheap) price for acquiring aerospace technology. According to the Japanese government, its cost per plane will exceed twice the cost of directly importing finished U.S. planes.

The Japanese government also played an important role in the arrangements made with Boeing. The three Japanese companies are building major components for all the new-generation Boeing 757s and 767s to be sold worldwide. Since Japan will buy only a fraction of those planes, its "local content" (i.e., domestic production value as a ratio of domestic sales value) will probably exceed 100 percent. The Japanese government had earlier forged the aerospace arms of Fuji, Kawasaki and Mitsubishi into the Civil Transports Development Corporation (CTDC). When arrangements for the 767 were made in the fall of 1978, Japanese production was extraordinarily uncompetitive on the world market because the yen was exchanging at 180 to the dollar. In addition, the Japanese government provided almost a $100 million subsidy to the CTDC to join the Boeing project. Finally, the Japanese government has leverage over Boeing since Japan Air Lines is government-owned and is a large potential customer for Boeing planes. Thus, the arrangements with Boeing—in an industry MITI has targeted for promotion—can hardly be considered the result of the free market.

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[1] Japan Economic Journal, Aug. 24, 1982, p. 20.

In the last year, the Japanese government has also actively intervened to help Japanese companies participate in the recently concluded jet engine project with United Technologies and Rolls Royce and potentially in new 150-seater aircraft project with Boeing or Airbus.

DISTORTIONS FROM TAX DIFFERENCES

U.S. trade problems with Japan are also aggravated by the GATT rules for border tax adjustment (BTA). Under the GATT rules, indirect taxes can be rebated on exports and imposed on imports. Since those rules were written, taxes have risen substantially the world over. The U.S. tended to add to its direct taxes while the Europeans and Japan tended to increase indirect taxes. This made U.S. imports from them carry low tax burdens but our exports to them bear a heavy tax burden.

In the 1950s and 1960s—when taxes were being raised—trade was far more marginal to the U.S. economy. In the last decade taxes have been stable but our exports and imports have grown rapidly. The detrimental effect of the BTA rules can no longer be brushed aside. (Given the current misalignment of exchange rates, the economists' standard rejoinder that exchange rates automatically adjust to offset BTA differences has an especially hollow ring.)

THE LOW DOLLAR VALUE OF THE YEN

Major shifts in international capital flows have raised the value of the dollar and lowered the value of the yen. As a result, the exchange rate of the yen has fallen far below what is justified on the grounds of trade flows. Many observers believe that on the basis of trade, the yen should have a value in the range of 180 to 200 to the dollar—about 20 percent higher than its current value. (At a more appropriate exchange rate, a Japanese car now costing $5,000 would cost $6,000.) The Japanese should be taking measures to reduce the net capital outflow from Japan which would have a direct impact of reducing their large trade surplus.

No discussion of exchange rates should fail to mention the effect of the tight monetary policy pursued by the U.S. This has forced up real interest rates to levels comparable to the start of the Great Depression (when prices were falling). As foreign funds have been attracted to the U.S., the exchange rate of the dollar has soared against all foreign currencies. The yen in particular was depressed because of such low interest rates in the sheltered Japanese capital market. As U.S. monetary policy has eased in the last half year, not only has the dollar fallen but the yen has strengthened. For trade purposes—not to mention the health of the domestic economy—that easier monetary policy must be continued.

Thus, both the U.S. and Japan can and should take measures to raise the value of the yen versus the dollar. However, as long as so much of the Japanese economy has such low productivity, the high productivity sectors will enjoy an advantage in trade competition. No sustainable appreciation of the yen can take that advantage away from them.

APPROPRIATENESS OF DOMESTIC AUTO CONTENT

The U.S. social fabric cannot afford rapid displacement of large manufacturing industries by the build-up of the counterpart Japanese industry. With the loss of a million jobs in recent years, U.S. auto communities now have depression-level rates of unemployment. High unemployment is expected to continue even if sales recover. The auto companies will have rapid increases in productivity in coming years. Cars and trucks will get even smaller to satisfy demands for fuel efficiency. With these inexorable pressures reducing employment, stability must be brought to the trade situation.

The domestic auto content bill, H.R. 1234, the Fair Practices in Automotive Products Act, is designed to bring some stability to U.S. auto trade. Both foreign and domestic auto companies would be put on notice that they must produce and buy here in substantial quantities if they intend to sell in large volume. So long as that is not clarified—whether or not Japanese export restraint is extended—the auto companies will spend their resources in planning and installing offshore capacity to supply this market. This would maintain competition in the domestic marketplace but prevent further massive erosion of the domestic production base.

Just as important, enactment of the bill would have a salutory effect on the problem that Japanese targeting causes in our market. Japanese policy makers would be put on notice that they can no longer expect U.S. passivity when Japanese industry adds capacity that displaces capacity—and jobs—in this U.S. industry. In the future, they would be more careful that their new growth industries do not have the same effect on the counterpart U.S. industry.

CONCLUSION

U.S. policy to handle trade problems with Japan must accept the fact that a government-assisted industrial strategy can succeed. The 1983 Economic Report of the President (page 60-61) expressed a mistaken but widespread American notion that interventionist measures "hurt the country which adopts them as well as other countries." Very often in the case of Japan interventionist policies have in fact benefitted the Japanese people, probably more than the spill-over harm to other countries.

The Japanese government has chosen specific strategic industries for promotion by assuring them control of the large domestic market and adoption of the world's best practice technology. If the effects could be confined to Japan, that would not be particularly "unfair". The real unfairness comes from the ensuing Japanese export drives that have rapidly displaced some American industries and jobs, coupled with a U.S. trade policy that considers passivity a virtue. In the name free trade, the U.S. has abstained from measures to eliminate or at least substantially mitigate the problems that arise from Japan's export drives. We cannot blame Japan for problems when we could have prevented them but failed to do so.

APPENDIX 1

Trade by Area and Commodity Groups - Japan ($ billions)

SOURCE: GATT, International Trade 1981/82 (1982)

	YEAR	UNITED STATES		CANADA		WESTERN EUROPE		EC		EFTA		OTHER WESTERN EUROPE		INDUSTRIAL COUNTRIES		AUSTRALIA, NEW ZEALAND AND SOUTH AFRICA		TRADITIONAL OIL EXPORTERS		OTHER DEVELOPING COUNTRIES		EASTERN TRADING AREA		TOTAL TRADE	
		EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP
FOOD	1973	.20	2.74	.04	.60	.10	.42	.13	.29	.07	.07	.02	.06	.40	5.77	.04	1.07	.07	.23	.20	1.66	.01	.33	.68	9.23
	1979	.20	5.73	.05	1.33	.21	1.21	.17	.94	.02	.13	.02	.24	.43	8.37	.04	2.11	.26	.45	.36	4.90	.01	.76	1.32	16.61
	1980	.26	6.36	.05	1.22	.21	1.19	.18	.97	.02	.11	.01	.21	.52	8.91	.06	2.27	.36	.47	.75	4.45	.02	.74	1.70	16.83
	1981	.23	7.49	.04	1.50	.17	1.34	.13	.90	.02	.14	.01	.21	.44	10.59	.08	2.10	.35	.39	.94	4.67	.02	.80	1.84	18.23
RAW MATERIALS	1973	.06	1.68	.01	.20	.09	.16	.08	.10	.01	.03	.01	.05	.14	2.11	.04	1.09	.09	.06	.35	1.06	.04	.05	.63	6.55
	1979	.04	3.56	.01	.81	.18	.28	.14	.15	.02	.12	.01	.62	.32	6.05	.06	1.00	.11	1.02	.32	3.47	.13	1.78	1.03	13.26
	1980	.05	3.33	.01	1.10	.17	.24	.14	.12	.02	.11	.01	.61	.21	6.07	.03	1.03	.15	1.00	.46	3.53	.25	1.16	1.22	17.00
	1981	.06	2.78	.01	.70	.13	.25	.11	.10	.07	.09	.01	.67	.10	3.73	.05	.99	.13	.78	.62	3.84	.27	.96	1.26	9.44
ORES AND OTHER MINERALS	1973		.13		.70	.01	.09	.01	.03		.01		.30	.01	1.71		1.37		.06	.03	1.73		.11	.05	4.44
	1979	.01	1.11		.79	.02	.12	.01	.09		.02		.02	.03	2.03	.02	2.13	.01	.21	.09	3.19	.01	.15	.16	7.72
	1980		1.44	.01	.88	.01	.13	.01	.07		.02		.04	.07	2.47	.02	2.49	.01	.30	.11	3.96	.02	.18	.17	9.65
	1981	.01	1.00		.73	.01	.11	.01	.06		.02		.03	.02	1.84	.03	2.37	.01	.27	.16	3.50	.21	.19	.16	8.25
FUELS	1973	.02	.62		.26		.01		.01					.02	.87		.57	.01	5.98	.06	.73		.30	.09	8.22
	1979	.10	1.36		.60		.14		.14		.01			.10	2.10	.01	1.96	.02	33.35	.19	5.02	.04	1.57	.36	45.28
	1980	.04	2.10		.74	.02	.04	.02	.04		.01			.07	3.04	.02	2.30	.03	53.72	.29	6.36	.10	2.74	.38	69.99
	1981	.04	2.63		.77	.02	.06	.02	.06		.04			.06	3.49	.03	2.91	.04	53.10	.20	9.75	.13	3.28	.35	72.50
NON FERROUS METALS	1973	.08	.21		.06	.03	.12	.03	.00		.03		.08	.12	.42		.19	.01	.03	.15	.72	.03	.31	.31	1.67
	1979	.29	.36	.01	.10	.12	.32	.11	.18	.01	.10		.05	.41	.84	.01	.52	.10	.16	.56	1.46	.05	.44	1.14	3.42
	1980	.55	.86	.01	.24	.33	.30	.30	.20	.03	.08	.01	.06	.89	1.41	.03	.06	.16	.36	.72	1.01	.12	.46	1.93	4.68
	1981	.36	.77	.01	.22	.23	.42	.20	.26	.02	.08		.07	.58	1.61	.04	.72	.15	.03	.60	1.27	.10	.36	1.47	4.19
TOTAL PRIMARY PRODUCTS	1973	.42	5.79	.05	1.90	.31	.76	.25	.51	.03	.13	.03	.18	.78	8.63	.09	4.16	.14	6.97	.87	6.88	.08	1.70	1.96	28.27
	1979	.66	12.13	.06	3.00	.52	2.17	.46	1.30	.05	.37	.03	.30	1.32	18.12	.13	7.72	.49	36.19	1.92	19.05	.24	6.23	4.08	85.31
	1980	.89	14.51	.07	4.19	.75	1.91	.65	1.29	.07	.31	.03	.36	1.71	20.61	.17	8.74	.70	56.35	2.42	21.09	.51	5.20	5.51	112.09
	1981	.66	14.60	.06	4.00	.56	2.19	.49	1.49	.08	.27	.02	.33	1.20	20.80	.20	9.22	.67	56.90	2.55	22.10	.57	5.67	5.27	112.09
IRON AND STEEL	1973	.97	.02	.11		.63	.04	.41	.01	.12	.02	.10		1.71	.07	.20	.08	.03		1.93	.05	.75	.08	5.31	.23
	1979	2.75	.05	.19	.01	.80	.10	.49	.05	.12	.09	.07	.02	3.63	.27	.30	.17	2.40	.02	4.76	.43	2.06	.06	14.11	.90
	1980	2.32	.06	.25	.02	.82	.13	.35	.03	.10	.07	.10	.03	3.76	.27	.46	.15	3.09	.03	5.64	.45	2.31	.07	15.49	.89
	1981	4.00	.05	.37	.02	.63	.11	.23	.03	.10	.06	.09	.01	4.80	.17	.41	.10	3.30	.05	5.40	.35	2.41	.20	16.67	1.07
CHEMICALS	1973	.77	.79	.02	.06	.35	.82	.28	.67	.06	.16	.02	.01	.66	1.69	.13	.06	.15		1.03	.13	.30	.09	2.25	1.95
	1979	.79	2.28	.08	.11	.98	2.00	.75	1.56	.12	.39	.07	.09	1.82	6.34	.32	.25	.35	.02	3.13	.58	.79	.18	6.61	5.40
	1980	1.03	2.79	.12	.19	1.10	2.13	.94	1.69	.16	.37	.08	.07	2.32	9.11	.30	.30	.49	.02	3.17	.78	1.01	.20	7.00	8.47
	1981	1.27	3.06	.14	.22	1.10	2.06	.90	1.66	.16	.36	.07	.06	2.57	9.37	.43	.31	.75	.01	3.21	.31	.90	.33	7.81	8.79
OTHER SEMI MANUFACTURES	1973	.26	.36	.03	.02	.23	.26	.16	.20	.04	.04	.09		.57	.57	.10	.11	.11		.30	.50	.04	.06	1.16	1.30
	1979	.56	.68	.08	.07	.40	.51	.32	.30	.07	.11	.02	.01	1.05	1.27	.19	.27	.06	.03	1.20	.93	.21	.11	3.30	2.60
	1980	.59	1.05	.10	.13	.49	.49	.30	.30	.09	.10	.02	.01	1.17	1.60	.27	.37	.07	.03	1.33	.87	.27	.13	4.11	3.06
	1981	.75	.87	.11	.11	.42	.67	.31	.30	.09	.08	.02	.01	1.30	1.65	.32	.33	1.11	.03	1.76	.84	.27	.13	4.73	2.70
TOTAL ENGINEERING PRODUCTS	1973	6.39	1.93	.04	.03	4.46	1.38	3.30	1.09	.94	.29	.72	.01	11.40	3.34	1.06	.02	1.22		5.10	.20	.65	.03	21.57	3.65
	1979	20.13	4.44	1.16	.07	12.36	2.99	10.21	2.30	1.07	.60	.47	.01	33.85	7.49	3.16	.06	7.93	.06	13.60	1.00	2.77	.10	64.31	8.73
	1980	24.28	5.17	1.72	.15	15.23	3.44	12.03	2.71	2.00	.72	.72	.02	42.23	8.77	4.09	.03	11.34	.01	21.64	1.37	3.94	.09	85.63	10.27
	1981	29.65	5.88	2.10	.08	19.27	3.17	15.24	2.50	2.24	.34	.60	.07	51.22	9.05	5.00	.03	14.03		25.09	1.47	6.30	.11	104.60	10.67
MACHINERY FOR SPECIALIZED INDUSTRIES	1973	.37	.47	.03	.01	.62	.30	.33	.46	.05	.12	.04		.85	1.06	.30	.01	.20		1.30	.02	.36	.02	2.97	1.00
	1979	1.92	.82	.15	.01	1.20	1.07	.90	.83	.14	.23	.12		3.27	1.91	.36	.01	1.19		4.01	.08	1.19	.02	11.01	2.01
	1980	2.16	.96	.20	.02	1.70	1.12	1.29	.80	.26	.26	.11		4.06	2.11	.70	.01	2.00		4.06	.10	1.76	.02	13.36	2.23
	1981	2.70	.98	.22	.03	1.68	.94	1.25	.71	.26	.23	.10		4.70	1.94	.90	.01	3.12		5.05	.11	2.19	.01	16.03	2.00
OFFICE AND TELECOMMUNICATIONS EQUIPMENT	1973	.72	.63	.07	.01	.69	.21	.39	.10	.07	.02	.03		1.28	.66	.08		.06		.50	.11	.02		1.94	.77
	1979	1.97	1.07	.12	.02	1.62	.26	1.31	.21	.20	.02	.10	.01	3.71	1.33	.23		.29		1.90	.33	.08		6.20	1.61
	1980	2.41	1.23	.13	.03	2.20	.28	1.70	.21	.29	.02	.13	.01	4.76	1.55	.36		.35		2.47	.46	.12		8.01	2.01
	1981	3.26	1.30	.17	.03	2.44	.24	2.02	.21	.30	.02	.12	.01	5.05	1.64	.47		.49		3.06	.50	.16		9.83	2.14
ROAD MOTOR VEHICLES	1973	2.30	.09	.22		.76	.10	.56	.10	.16		.01		3.28	.19	.45		.36		.70		.04		4.90	.19
	1979	9.75	.24	.30		3.56	.40	2.09	.40	.06	.02	.03		13.67	.21	1.26		2.36		3.16	.01	.27		20.69	.27
	1980	12.05	.19	.76		4.76	.42	3.02	.40	1.07	.02	.07		17.57	.40	1.00		3.63		4.60	.01	.28		26.09	.01
	1981	13.52	.13	1.20		5.09	.33	3.78	.32	1.26	.01	.06		19.01	.46	2.42		4.00		4.93	.01	.30		32.07	.40
OTHER MACHINERY AND TRANSPORT EQUIPMENT	1973	1.36	.86	.17	.01	1.02	.36	2.21	.29	.30	.06	.10		3.28	1.77	.20	.01	.35		1.60	.10	.23	.01	7.01	1.33
	1979	3.06	2.14	.23	.02	2.99	.96	2.36	.76	.57	.22	.08		8.31	3.17	.36	.02	2.36	.01	5.56	.40	1.07	.00	17.22	3.62
	1980	3.84	2.63	.26	.08	3.28	1.36	2.55	1.03	.56	.33	.10		7.30	4.00	.49	.01	3.19	.01	6.27	.32	1.51	.00	21.27	4.68
	1981	4.05	3.15	.39	.02	4.76	1.46	3.04	1.30	.09	.20	.26	.06	9.14	4.67	1.03	.02	4.16		7.59	.40	1.34	.09	26.36	5.32
HOUSEHOLD APPLIANCES	1973	1.65	.08	.17		.87	.19	.00	.07	.13	.08	.04		2.79	.27	.13		.19		.72	.03	.02		3.05	.27
	1979	3.39	.16	.31	.01	3.10	.26	2.72	.16	.33	.10	.14		6.09	.60	.36		1.34		2.38	.30	.16		11.12	.72
	1980	3.82	.16	.30	.02	4.20	.25	3.59	.18	.30	.09	.19		8.48	.43	.33		1.97		3.46	.20	.20		14.71	.73
	1981	5.66	.17	.35	.01	5.31	.20	4.59	.12	.37	.08	.19		11.72	.39	.77		2.17		3.07	.26	.31		18.04	.65
TEXTILES	1973	.27	.11	.06		.15	.29	.09	.25	.03	.03	.01		.46	.41	.29		.30		1.17	.55	.19	.16	2.49	1.13
	1979	.35	.13	.08		.28	.52	.23	.45	.03	.07	.01		.71	.65	.20		.61	.01	1.80	1.03	.31	.25	4.00	2.03
	1980	.38	.13	.06		.39	.47	.33	.40	.05	.04	.01	.01	.63	.60	.33		1.20	.01	2.19	.73	.35	.31	5.10	1.65
	1981	.34	.14	.08		.30	.42	.22	.36	.03	.06	.02		1.00	.56	.30		1.43	.01	2.32	.78	.70	.31	5.03	1.63
CLOTHING	1973	.73	.02	.02		.04	.09	.04	.09		.01			.29	.11	.01		.01		.06	.62	.01	.05	.37	.57
	1979	.16	.09	.01	.01	.06	.36	.06	.31	.01	.02		.02	.75	.48	.01		.03		.06	1.17	.02	.10	.35	1.60
	1980	.21	.09	.01	.01	.09	.36	.07	.31	.02	.02		.01	.31	.45	.01		.00		.09	.95	.03	.26	.50	1.33
	1981	.28	.09	.01	.01	.09	.31	.06	.26	.02	.02		.02	.37	.47	.02		.00		.10	1.12	.03	.25	.58	1.88
OTHER CONSUMER GOODS	1973	.62	.28	.06	.01	.39	.43	.29	.36	.08	.06	.02	.01	1.07	.71	.09	.01	.06		.23	.21	.02	.11	1.47	1.05
	1979	.97	.52	.08	.01	.93	.82	.75	.70	.16	.10	.04	.03	1.90	1.15	.11		.30	.01	.70	.79	.07	.11	3.72	2.10
	1980	1.21	.50	.11	.01	1.39	.83	1.12	.75	.30	.09	.07	.03	2.71	1.26	.14		.51		.97	.73	.12	.16	4.48	2.22
	1981	1.57	.57	.13	.01	1.47	.79	1.10	.60	.27	.10	.07	.03	3.17	1.37	.26	.01	.57		1.17	.68	.09	.15	5.23	2.30
TOTAL MANUFACTURES	1973	9.61	3.48	.98	.11	6.28	3.30	4.57	2.66	1.26	.60	.30	.06	16.10	6.09	1.90	.29	2.17	.02	6.99	2.81	1.06	.31	36.10	9.60
	1979	23.72	8.19	1.67	.28	13.66	7.35	12.00	5.65	2.36	1.37	.70	.19	42.36	15.12	4.06	.78	12.00	.00	20.60	6.01	7.02	1.07	87.90	23.77
	1980	30.41	9.79	2.37	.31	20.58	7.03	16.21	6.22	3.30	1.66	.90	.17	53.16	18.13	5.68	.06	17.72	.11	23.23	3.73	8.66	1.20	122.60	26.09
	1981	37.86	10.56	3.16	.45	25.17	7.36	18.20	5.93	3.05	1.20	1.06	.20	64.37	18.19	7.66	.30	22.14	.11	30.11	6.36	6.76	1.49	145.35	27.09
TOTAL(a)	1973	9.57	9.28	1.00	2.01	6.81	4.07	4.87	3.19	1.32	.74	.42	.16	17.16	19.34	2.08	4.40	2.72	7.00	10.68	9.16	2.06	2.31	36.93	38.31
	1979	26.60	20.67	1.76	4.08	16.03	9.65	13.46	7.65	2.46	1.75	.76	.03	44.97	30.17	4.19	8.40	13.36	36.33	21.67	25.00	7.30	9.35	102.96	110.11
	1980	31.45	24.45	2.44	4.72	21.00	9.88	17.10	7.64	3.11	3.76	1.03	.41	55.11	30.00	6.07	9.08	18.46	56.40	35.88	26.11	9.10	8.02	129.54	139.89
	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.06	.34	66.36	30.45	7.02	10.03	23.38	56.96	41.00	21.07	9.01	3.10	151.91	140.03

Trade by Area and Commodity Groups - United States ($ billions)

APPENDIX 2

SOURCE: GATT, International Trade 1981/82 (1982)

	YEAR	CANADA		JAPAN		WESTERN EUROPE		EC		EFTA		OTHER WESTERN EUROPE		INDUSTRIAL COUNTRIES		AUSTRALIA NEW ZEALAND SOUTH AFRICA		TRADITIONAL OIL EXPORTERS		OTHER DEVELOPING COUNTRIES		EASTERN TRADING AREA		TOTAL TRADE	
		EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP
FOOD	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
RAW MATERIALS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
ORES AND OTHER MINERALS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
FUELS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
NON FERROUS METALS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL PRIMARY PRODUCTS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
IRON AND STEEL	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
CHEMICALS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
OTHER SEMI MANUFACTURES	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL ENGINEERING PRODUCTS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
MACHINERY FOR SPECIALIZED INDUSTRIES	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
OFFICE AND TELECOMMUNICATIONS EQUIPMENT	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
ROAD MOTOR VEHICLES	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
OTHER MACHINERY AND TRANSPORT EQUIPMENT	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
HOUSEHOLD APPLIANCES	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TEXTILES	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
CLOTHING	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
OTHER CONSUMER GOODS	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL MANUFACTURES	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL(a)	1973	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1979	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1980	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	1981	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Trade by Area and Commodity Groups - European Community ($ billions)
SOURCE: GATT, International Trade 1981/82 (1982)

APPENDIX 3

	YEAR	UNITED STATES		CANADA		JAPAN		WESTERN EUROPE		EC		EFTA		OTHER WESTERN EUROPE		INDUSTRIAL COUNTRIES		AUSTRALIA NEW ZEALAND SOUTH AFRICA		[illegible] OIL EXPORTERS		OTHER DEVELOPING COUNTRIES		[illegible] TRADING AREA			
		EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP	EXP	IMP
FOOD	1973	1.43	4.67	.21	.90	.30	.17	19.27	20.10	17.12	17.17	1.71	1.11	.43	1.07	21.20	29.04	.17	1.79	.70	.76	2.14	8.43	.67	1.43	25.16	38.45
	1979	2.40	8.07	.42	1.40	.79	.18	47.20	46.04	42.84	41.36	3.36	2.04	1.01	3.24	50.89	57.37	.36	2.10	3.53	1.06	5.53	15.31	1.80	2.04	67.20	82.18
	1980	2.62	10.01	.47	1.63	.74	.30	51.36	51.67	46.33	45.81	3.79	2.26	1.26	3.66	55.30	63.51	.39	2.22	4.75	1.51	7.04	19.43	3.27	2.17	71.71	66.00
	1981	2.76	9.68	.45	1.64	.87	.19	47.28	46.90	42.59	41.72	3.51	1.97	1.18	3.21	51.35	58.41	.40	2.60	6.66	1.05	7.27	16.73	3.07	1.67	65.53	80.16
RAW MATERIALS	1973	.10	.43	.05	.34	.09	.06	4.50	6.80	3.97	3.32	.63	3.00	.20	.30	4.83	8.62	.06	1.47	.06	.41	.26	2.74	.31	1.15	5.53	14.47
	1979	.24	2.26	.07	1.43	.15	.16	9.46	13.79	7.28	7.50	1.26	5.66	.60	.64	10.30	17.63	.10	2.20	.17	.65	.46	4.60	.57	2.10	11.45	27.47
	1980	.28	2.77	.07	1.05	.11	.13	10.05	14.05	7.95	7.73	1.40	6.29	.42	.60	10.31	19.41	.13	2.17	.26	.04	.36	5.35	.70	2.43	11.15	30.14
	1981	.30	2.10	.08	1.57	.15	.10	9.15	13.63	7.15	6.83	1.42	5.71	.39	.67	9.70	16.40	.14	1.70	.23	.47	.59	4.06	.06	2.02	11.37	24.80
ORES AND OTHER MINERALS	1973	.06	.45	.01	.67	.02	.01	2.06	3.01	1.70	1.93	.26	.16	.10	.12	2.15	3.90	.01	.45	.06	.16	.06	1.00	.04	.20	2.24	6.67
	1979	.15	1.61	.03	1.41	.06	.03	5.39	6.11	4.24	4.55	.65	1.10	.20	.33	5.65	9.36	.02	1.30	.12	.37	.17	3.66	.18	.52	6.17	15.09
	1980	.27	2.35	.03	1.60	.04	.03	6.45	7.12	5.15	5.23	.75	1.33	.35	.44	6.79	11.31	.03	1.65	.17	.36	.19	4.36	.23	.60	7.40	18.31
	1981	.20	1.65	.01	1.39	.04	.03	4.59	5.30	3.89	4.17	.60	1.05	.50	.37	5.25	8.44	.64	1.41	.17	.38	.21	3.67	.22	.48	5.43	14.93
FUELS	1973	.36	.45	.01	.01	.01		7.31	9.70	5.67	5.28	1.40	.15	.16	.81	7.00	6.20	.02	.10	.10	17.15	.26	.64	.05	1.30	8.70	25.43
	1979	1.06	1.50	.04	.17	.07	.01	21.95	33.10	23.66	21.41	6.63	5.30	.06	.57	23.90	34.60	.08	.97	1.30	62.93	1.42	5.16	.37	9.37	26.67	113.16
	1980	2.33	2.20	.12	.16	.03	.01	42.42	43.86	35.60	34.04	6.43	6.52	.70	.49	45.40	46.53	.10	1.25	1.62	88.50	2.07	6.04	.40	13.45	53.75	155.93
	1981	5.67	3.17	.43	.12	.01	.01	43.74	46.01	36.04	36.42	6.17	5.05	.93	.54	49.40	49.31	.11	1.35	2.06	75.34	1.05	10.93	.37	13.71	57.42	155.44
NON FERROUS METALS	1973	.46	.67	.04	.45	.11	.03	4.10	4.25	3.37	3.74	.57	.03	.21	.10	4.71	5.20	.05	.30	.09	.09	.27	2.00	.20	.40	2.40	8.36
	1979	.80	1.02	.08	.43	.15	.10	10.17	10.91	8.70	8.25	1.40	2.32	.29	.36	11.25	12.45	.07	1.00	.32	.23	.70	3.10	.46	.75	12.01	17.76
	1980	.96	2.40	.05	.73	.14	.26	15.21	14.32	11.04	10.76	3.02	2.46	.33	.06	16.38	17.00	.11	1.30	.47	.30	.75	4.18	.52	.06	18.75	24.70
	1981	.52	1.13	.05	.30	.21	.22	9.67	9.77	7.34	7.15	1.90	2.13	.33	.07	10.06	11.08	.13	.84	.52	.34	.75	3.01	.30	.50	12.65	16.40
TOTAL PRIMARY PRODUCTS	1973	[illegible]	7.01	.31	2.50	.12	.26	37.24	39.70	31.45	31.19	4.59	5.69	1.20	2.74	40.55	49.65	.31	4.20	.50	18.45	2.07	15.40	1.56	4.92	43.17	93.37
	[illegible]	[illegible]	15.44	.63	4.92	1.21	.48	104.37	110.82	88.66	86.36	12.40	16.30	3.10	5.60	111.07	121.67	.61	7.07	5.40	65.40	6.29	35.90	3.33	14.92	132.75	256.28
	[illegible]	[illegible]	[illegible]	.73	5.90	1.07	.46	126.00	131.63	106.13	104.55	16.30	21.20	3.57	5.61	134.29	138.56	.77	6.63	8.45	91.57	10.40	42.09	5.13	19.06	163.33	321.94
	[illegible]	[illegible]	[illegible]	1.09	5.23	1.28	.34	114.04	120.90	97.00	96.31	13.00	19.43	3.56	5.11	127.02	144.29	.81	7.09	9.57	81.56	10.00	30.58	5.43	10.67	157.30	291.61
[illegible]	[illegible]	[illegible]	[illegible]	.14	.38	.02	.42	9.63	8.73	7.40	7.43	1.55	.48	.68	.70	10.76	9.36	.14	.10	.66	.02	1.03	.10	1.62	.40	14.20	10.15
	[illegible]	[illegible]	[illegible]	.30	.60	.06	.46	20.14	19.01	16.19	16.66	2.80	2.45	1.07	.06	22.76	20.39	.19	.32	2.36	.66	2.91	.50	4.67	.66	37.04	22.40
	[illegible]	[illegible]	[illegible]	.20	.14	.03	.60	22.42	22.09	17.04	16.07	3.47	3.15	1.30	.02	24.30	23.30	.23	.30	2.79	.66	3.16	.79	3.63	.49	34.18	25.54
	[illegible]	[illegible]	[illegible]	.51	.07	.04	.26	17.40	16.74	13.55	13.71	2.75	2.45	1.15	.50	21.70	17.35	.25	.10	3.09	.03	5.44	.40	2.66	.72	31.06	19.77
[illegible]	[illegible]	[illegible]	[illegible]	.21	.13	.50	.29	15.66	13.40	11.43	11.05	2.01	1.45	1.22	.17	17.45	15.07	.06	.06	.01	.03	3.00	.30	1.16	.34	23.34	16.01
	[illegible]	[illegible]	[illegible]	.56	.36	1.33	.28	49.53	44.37	38.56	36.10	7.48	4.79	3.66	.04	55.03	51.53	1.53	.30	3.47	.15	6.04	1.36	4.01	1.90	72.17	55.40
	[illegible]	[illegible]	[illegible]	.53	.49	1.44	.90	53.23	45.12	43.00	43.12	9.05	5.10	2.26	.63	60.06	57.14	1.74	.32	5.06	.26	6.61	1.01	5.04	2.01	81.67	61.00
	[illegible]	[illegible]	[illegible]	.52	.52	1.45	.97	44.51	44.76	38.52	39.09	7.82	4.89	2.97	.70	54.64	52.23	1.03	.50	5.36	.15	8.55	1.49	4.02	2.00	74.77	54.57
[illegible]	[illegible]	[illegible]	.69	.12	.31	.10	.20	9.26	10.70	7.00	7.07	1.03	3.05	.25	.24	10.27	11.91	.27	.50	.29	.08	1.23	1.07	.33	.06	12.90	14.25
	[illegible]	1.70	1.63	.22	.62	.30	.41	27.60	27.10	19.01	19.33	6.03	10.07	.16	.94	27.00	33.04	.43	.60	1.06	.19	3.26	3.10	.79	1.31	30.23	35.06
	[illegible]	2.67	2.06	.23	.72	.33	.52	30.95	35.40	22.28	22.24	7.88	12.39	.82	1.22	34.02	39.19	.36	.45	2.31	.13	3.71	3.01	.67	1.06	41.92	40.07
	1981	2.40	1.81	.25	.25	.35	.42	30.05	31.36	18.04	18.97	6.64	11.27	.75	1.12	29.05	30.36	.30	.50	2.56	.12	3.53	2.52	.71	1.37	36.47	39.05
[illegible]EERING	1973	7.45	7.11	1.12	.20	.95	2.75	53.53	44.69	30.36	30.15	10.95	5.80	3.02	.02	63.06	54.03	2.00	.11	4.45	.06	9.09	.02	5.56	.71	83.71	56.32
	1979	15.91	18.79	2.11	.62	2.12	10.90	130.44	120.23	103.77	101.51	25.55	14.85	6.52	3.04	150.20	150.04	5.55	.19	22.10	.76	20.00	4.50	5.50	1.94	222.31	132.71
	1980	18.01	24.43	2.71	.00	2.26	14.02	132.76	133.37	114.43	111.63	28.98	14.80	6.76	4.07	175.21	172.65	7.51	.26	27.26	.01	32.26	6.71	6.26	2.13	271.07	182.45
	1981	17.09	24.48	2.62	.06	2.09	14.91	131.94	114.37	58.56	96.00	26.40	14.30	8.52	4.11	133.90	136.79	0.09	.22	31.57	.07	31.03	9.03	7.14	1.04	233.14	163.06
MACHINERY FOR SPECIALIZED INDUSTRIES	1973	1.39	1.30	.34	.06	.43	.05	15.09	13.24	10.15	10.21	3.30	1.09	1.73	.19	17.29	14.23	.02	.03	1.50	.01	3.12	.06	2.70	.21	25.07	14.52
	1979	3.03	3.39	.69	.15	.76	1.03	33.92	28.67	23.12	23.46	6.09	4.06	3.61	.92	39.19	33.42	1.04	.05	6.96	.00	9.24	.22	5.70	.32	62.14	34.32
	1980	4.33	4.48	.77	.18	.77	1.37	39.09	37.91	27.03	20.01	6.01	5.01	3.41	.05	46.92	38.94	2.09	.00	7.79	.64	10.38	.28	5.20	.58	70.00	40.01
	1981	4.53	4.30	.77	.19	.04	1.30	31.05	26.22	21.30	21.12	3.93	4.94	2.50	.92	37.70	32.00	2.09	.00	4.01	.03	10.00	.29	3.60	.44	42.20	32.53
OFFICE AND TELECOMMUNICATIONS EQUIPMENT	1973	.90	1.40	.09	.00	.16	.37	4.46	4.16	3.41	3.70	.70	.42	.20	.04	5.07	6.21	.24	.02	.25		.65	.19	.15	.04	7.01	6.67
	1979	[illegible]	[illegible]	[illegible]	[illegible]	.20	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	.73	.70	[illegible]	[illegible]	.00	.00	[illegible]	.00	[illegible]	.90	.39	.49	[illegible]	[illegible]
	1980	1.20	6.07	.10	.10	.23	1.08	14.19	11.97	11.03	10.30	2.24	1.39	.07	.27	15.72	20.09	.51	.02	1.74	.06	2.60	1.21	.31	.09	21.09	22.03
	1981	1.15	6.03	.12	.19	.10	2.09	13.76	11.10	10.37	9.64	2.16	1.36	.02	.19	14.74	20.02	.04	.03	1.07	.03	2.23	1.71	.26	.01	19.31	21.37
ROAD MOTOR VEHICLES	1973	3.15	.26	.23	.01	.00	.03	13.50	10.70	10.05	10.02	2.04	.37	.19	.21	16.34	11.70	.76	.01	.06		1.76	.02	.20	.12	20.23	11.66
	1979	5.34	.06	.53	.07	.42	3.19	39.61	34.93	31.00	31.12	6.06	3.14	1.09	1.07	46.11	39.29	1.65	.02	3.62	.01	4.70	.23	.43	.06	56.32	40.02
	1980	5.00	.69	.40	.02	.39	4.39	40.21	36.94	31.94	30.54	6.39	2.17	1.06	2.79	46.08	40.00	1.62	.03	5.39	.01	5.16	.26	.30	.04	59.65	40.07
	1981	4.65	.63	.31	.02	.33	4.44	36.15	30.40	22.00	20.07	5.81	1.80	1.04	1.04	39.43	30.50	1.71		7.16	.01	5.18	.31	.20	.34	53.77	36.76
OTHER MACHINERY AND TRANSPORT EQUIPMENT	1973	2.79	3.62	.30	.13	.21	.62	15.94	13.30	11.29	10.94	3.63	2.09	1.02	.35	18.03	17.37	.76	.05	1.90	.05	3.17	.32	.05	.21	23.90	16.32
	1979	4.76	6.71	.67	.20	.61	2.20	40.76	36.71	30.95	30.24	7.32	5.31	2.49	1.10	46.01	47.56	1.70	.09	9.62	.03	11.27	1.70	2.10	.72	74.99	50.07
	1980	5.95	11.45	.73	.30	.70	2.09	46.72	42.09	34.87	34.74	6.06	5.99	2.90	1.16	54.10	50.06	2.37	.12	10.73	.70	12.56	2.25	2.00	.00	83.49	61.60
	1981	6.95	12.18	.73	.30	.75	2.72	42.07	37.70	32.52	31.42	7.01	5.11	2.04	1.19	51.38	52.97	2.71	.12	12.27	.50	13.73	3.12	2.17	.00	82.27	56.67
HOUSEHOLD APPLIANCES	1973	.42	.25	.00	.01	.07	.77	4.39	4.10	3.32	3.27	.69	.74	.18	.08	4.95	5.13	.14	.08	.15		.31	.26	.06	.07	5.80	5.02
	1979	.09	.70	.12	.04	.13	2.79	10.16	9.71	7.32	7.08	1.90	1.01	.52	.31	11.60	13.75	.24	.01	.72	.01	.95	1.73	.16	.19	13.66	15.23
	1980	.67	.76	.11	.05	.13	3.59	10.82	10.50	8.10	8.46	2.12	1.76	.50	.39	11.76	14.93	.20	.01	.96	.31	1.09	2.16	.16	.22	16.03	17.30
	1981	.62	.74	.09	.06	.13	6.37	9.36	9.13	7.11	7.15	1.23	1.02	.01	.30	10.10	14.21	.31	.08	.90		1.14	1.92	.12	.15	13.81	16.47
TEXTILES	1973	.91	.32	.19	.03	.25	.10	8.24	7.04	6.00	6.49	1.35	.74	.40	.26	9.19	7.09	.32		.34	.25	.75	.73	.55	.22	11.16	5.16
	1979	.00	1.02	.20	.06	.41	.29	17.74	16.65	14.41	14.06	2.62	1.91	.70	.06	18.99	18.08	.30	.03	.77	.06	1.45	2.30	1.06	.08	22.63	21.62
	1980	.05	1.23	.10	.09	.36	.30	18.51	17.23	16.09	14.31	2.08	2.05	.73	.01	19.60	18.93	.41	.03	1.09	.40	1.44	2.01	1.25	.00	26.02	22.96
	1981	.73	.06	.19	.07	.33	.39	15.53	14.73	12.50	12.24	2.40	1.85	.04	.03	16.70	16.03	.45	.07	1.15	.27	1.01	2.00	1.00	.07	21.12	19.69
CLOTHING	1973	.27	.05	.06	.02	.00	.04	4.19	4.10	3.39	3.42	.49	.30	.10	.10	4.59	4.26	.03	.01	.06		.17	1.10	.11	.30	4.90	5.01
	1979	.45	.21	.00	.04	.27	.07	11.23	11.34	8.95	9.24	2.09	1.10	.19	.90	12.03	11.77	.03	.06	.30	.03	.50	6.77	.13	1.34	13.11	17.76
	1980	.41	.43	.07	.06	.26	.11	12.47	12.52	9.00	10.21	2.37	1.30	.22	1.00	13.21	13.13	.05	.06	.52	.02	.62	5.00	.17	1.70	16.90	20.27
	1981	.40	.30	.00	.04	.24	.00	10.38	10.59	8.30	8.52	2.05	1.15	.19	.92	11.31	11.08	.06	.06	.76	.06	.90	5.30	.16	1.11	12.61	17.77
OTHER CONSUMER GOODS	1973	1.40	.61	.25	.06	.25	.33	8.68	7.05	6.59	6.56	1.83	.56	.29	.42	10.50	8.03	.20	.02	.31	.01	.72	.52	.15	.30	11.97	9.96
	1979	3.34	1.00	.65	.09	.54	.00	23.70	23.67	19.01	19.64	5.22	2.79	.67	1.05	30.03	26.16	.40	.07	2.66	.03	3.65	2.51	.32	1.15	40.25	29.96
	1980	3.00	2.20	.46	.13	.54	1.20	28.67	26.37	21.84	21.93	6.00	3.20	.75	1.15	32.67	29.99	.35	.09	3.68	.04	2.04	3.70	.37	1.25	36.67	34.02
	1981	3.34	2.19	.46	.13	.52	1.20	26.13	22.20	18.27	18.35	5.22	2.00	.06	1.01	30.23	23.89	.37	.07	3.70	.03	3.01	2.06	.35	1.26	30.13	30.30
TOTAL MANUFACTURES	1973	13.10	10.91	2.09	.09	2.30	6.12	100.00	97.11	81.21	81.33	20.92	13.69	6.07	2.45	120.30	113.03	4.39	.01	7.03	.02	15.70	6.07	2.65	3.10	162.74	122.40
	1979	28.13	29.94	3.07	1.06	5.06	13.70	240.37	267.00	221.72	210.74	51.27	30.29	15.30	9.06	325.44	312.00	8.75	1.39	33.32	1.03	46.30	15.33	20.15	9.25	436.74	345.02
	1980	29.94	37.44	3.07	2.43	5.19	17.03	321.00	290.64	263.50	261.99	62.32	44.87	16.77	10.51	360.05	334.30	11.19	1.96	62.12	1.00	53.11	27.32	20.62	10.44	447.79	392.79
	1981	31.91	35.94	4.02	2.43	6.90	18.36	276.09	255.02	208.30	206.95	31.77	20.64	14.04	5.15	315.91	311.73	13.04	1.58	40.40	1.31	52.41	20.05	15.49	8.75	443.75	344.46
TOTAL***	1973	15.70	18.20	2.42	3.50	2.05	6.62	147.33	138.12	113.01	113.25	25.73	16.35	7.40	5.21	160.30	166.32	4.91	5.10	8.00	39.09	19.13	20.43	8.10	8.17	211.96	217.63
	1979	34.61	46.50	4.60	6.00	6.30	14.32	358.72	383.42	313.21	311.46	64.76	56.09	18.75	14.71	444.37	450.13	9.06	9.58	39.65	67.26	56.24	50.01	23.72	26.40	577.26	628.73
	1980	33.20	60.29	4.77	8.34	6.36	18.55	453.96	434.19	355.17	330.35	70.16	67.17	20.01	16.52	502.27	521.57	12.27	10.69	51.59	53.32	63.03	67.03	25.46	30.31	662.39	725.30
		[illegible]	[illegible]	[illegible]	[illegible]	6.16	16.92	397.50	361.13	310.17	306.07	46.08	46.02	18.66	16.44	449.62	462.01	13.17	5.62	35.63	83.00	64.30	60.00	21.76	27.50	613.57	644.72

WORLD

APPENDIX 4

WORLD-PRODUCTION 1940-1981

Motor Vehicles-Selected Countries

	United States	Canada	Japan	France	Germany	Italy	United Kingdom	Total pp. 12 & 13	Total
1940	4,472,286	223,103	-	-	72,000	-	133,869	-	4,901,168
1941	4,840,502	270,191	-	-	-	-	145,430	-	5,256,123
1942	1,041,524	228,293	-	-	-	-	160,522	-	1,430,339
1943	699,828	178,084	-	-	-	-	149,318	-	1,027,210
1944	738,134	158,038	-	-	-	-	132,955	-	1,029,127
1945	725,215	132,645	-	34,625	6,805	10,290	139,405	74,700	1.123,685
1946	3,100,820	170,635	14,921	96,062	30,671	28,983	359,634	111,624	3,913,410
1947	4,795,587	242,107	11,320	137,383	23,258	43,736	441,284	158,876	5,853,550
1948	5,220,755	261,009	20,367	198,372	61,198	59,953	507,608	235,588	6,564,850
1949	6,263,834	290,664	28,700	285,641	163,504	86,054	628,196	317,518	8,044,111
1950	8,005,859	387,726	31,597	357,552	306,034	127,847	783,672	577,526	10,577,013
1951	6,757,014	415,420	38,490	445,655	374,108	145,553	733,883	541,491	9,451,614
1952	5,561,796	434,102	38,966	498,962	428,016	138,446	689,657	529,573	8,319,519
1953	7,349,123	486,049	49,778	497,348	490,068	174,320	834,275	617,326	10,498,265
1954	6,536,729	352,100	70,073	600,040	680,509	216,715	1,037,879	730,919	10,224,973
1955	9,204,049	452,114	68,932	725,061	908,702	268,766	1,237,068	877,998	13,742,690
1956	6,918,759	471,350	111,066	827,079	1,075,603	315,807	1,004,544	927,798	11,652,001
1957	7,220,431	413,577	181,977	927,956	1,212,206	351,815	1,149,095	1,071,323	12,528,380
1958	5,121,269	356,418	188,303	1,127,549	1,495,221	403,560	1,364,407	1,297,610	11,354,337
1959	6,723,588	367,939	262,814	1,283,159	1,718,544	500,784	1,560,427	1,453,231	13,870,486
1960	7,905,117	397,739	481,551	1,369,210	2,055,127	644,633	1,810,700	1,712,801	16,376,878
1961	6,652,038	386,923	813,879	1,244,223	2,147,825	759,140	1,464,134	1,740,459	15,209,521
1962	8,197,311	505,187	990,706	1,536,133	2,356,594	946,793	1,674,530	1,991,011	18,198,265
1963	9,108,776	631,356	1,283,531	1,736,977	2,667,896	1,180,536	2,011,720	2,090,231	20,711,023
1964	9,307,860	670,990	1,702,475	1,615,896	2,909,657	1,090,078	2,332,376	2,385,092	22,014,424
1965	11,137,830	846,609	1,875,614	1,641,698	2,976,477	1,175,548	2,177,261	2,729,310	24,560,345
1966	10,396,299	872,214	2,286,399	2,024,552	3,050,708	1,365,898	2,042,354	2,936,889	24,975,313
1967	9,023,736	919,500	3,146,486	2,009,672	2,482,319	1,542,669	1,937,119	3,105,694	24,167,203
1968	10,820,410	1,150,218	4,085,825	2,075,617	3,106,958	1,660,370	2,225,122	3,451,944	28,576,465
1969	10,205,911	1,326,478	4,674,923	2,459,072	3,604,567	1,595,951	2,182,793	3,979,582	30,029,277
1970	8,283,949	1,159,504	5,289,147	2,750,086	3,842,247	1,854,252	2,098,498	4,411,216	29,688,899
1971	10,671,654	1,346,765	5,810,774	3,010,294	3,982,722	1,817,019	2,198,146	4,869,933	33,707,307
1972	11,310,708	1,430,084	6,294,438	3,328,320	3,815,982	1,839,793	2,329,430	5,387,508	35,736,263
1973	12,681,513	1,574,820	7,082,757	3,596,179	3,949,065	1,957,994	2,163,941	6,184,546	39,190,815
1974	10,072,662	1,524,874	6,551,840	3,462,847	3,099,777	1,772,515	1,936,685	6,559,103	34,980,303
1975	8,986,605	1,424,006	6,941,591	2,861,305	3,186,208	1,458,629	1,648,399	6,792,274	33,299,017
1976	11,497,391	1,640,112	7,841,447	3,402,715	3,868,089	1,590,677	1,705,506	7,034,015	38,579,952
1977	12,702,782	1,775,445	8,514,522	3,507,881	4,104,216	1,583,917	1,714,240	7,301,785	41,204,788
1978	12,899,202	1,817,457	9,269,153	3,507,930	4,186,364	1,656,115	1,607,467	7,684,392	42,628,080
1979	11,479,993	1,631,661	9,635,546	3,613,458	4,249,743	1,632,289	1,478,512	8,188,308	41,909,508
1980	8,009,841	1,374,359	11,042,884	3,378,433	3,878,553	1,610,287	1,312,914	8,176,485	38,783,756
1981	7,942,916	1,322,780	11,179,962	3,019,370	3,897,007	1,433,743	1,184,205	7,570,862	37,550,845

NOTE: Different from world total shown on page 8 since this total is inclusive of production and assemblies for the countries listed.

VARIOUS SOURCES

Source: Motor Vehicle Manufacturers Association of the United States - World Motor Vehicle Data (1982 edition)

APPENDIX 5

WORLD - NEW REGISTRATIONS 1928-1981

Motor Vehicles-Selected Countries (In Thousands)

	Canada	Belgium	France	Germany	Italy	Japan	Netherlands	Sweden	Switzerland	U.K.	U.S.
1928..........	-	-	-	-	17.9	-	-	-	-	213.2	3,480.7
1929..........	-	-	222.4	-	39.1	-	-	24.1	-	237.4	4,407.3
1930..........	-	-	225.6	97.1	31.1	-	-	22.2	-	225.0	3,036.7
1931..........	-	-	188.3	68.8	18.5	-	-	19.5	-	205.9	2,222.0
1932..........	45.9	-	166.1	48.0	22.8	-	-	8.0	-	210.3	1,276.8
1933..........	45.3	-	177.2	93.6	32.0	-	-	8.5	-	248.5	1,739.7
1934..........	73.4	-	176.6	154.4	34.2	-	-	15.5	-	309.4	2,292.4
1935..........	101.5	-	162.4	213.9	29.6	-	-	20.5	-	363.0	3,254.6
1936..........	113.3	-	190.2	258.8	24.6	-	-	26.1	-	411.0	4,016.1
1937..........	144.4	-	185.0	261.8	39.7	-	-	34.6	-	419.0	4,102.0
1938..........	121.2	-	205.7	272.7	45.0	-	-	43.0	-	374.8	2,256.4
WAR YEARS....	-	-	-	-	-	-	-	-	-	-	-
1946..........	120.0	-	67.5	7.3	22.0	-	-	19.4	8.5	246.8	2,440.4
1947..........	230.3	-	62.3	6.3	27.7	-	-	35.5	22.8	299.6	4,346.4
1948..........	221.3	-	112.4	26.8	43.9	-	-	25.4	26.9	246.4	4,526.1
1949..........	286.3	-	175.5	114.5	64.5	-	-	22.4	27.6	289.8	5,800.3
1950..........	429.7	-	238.8	262.7	99.7	25.9	-	73.2	31.1	250.9	7,468.7
1951..........	385.6	-	317.9	253.0	107.4	35.7	-	74.0	33.3	246.9	6,064.8
1952..........	400.8	-	378.5	276.8	110.5	48.5	-	63.9	33.3	293.5	4,970.5
1953..........	463.7	-	378.0	320.1	139.6	63.8	-	89.7	39.8	417.4	6,669.3
1954..........	377.6	-	443.4	466.3	167.6	74.8	-	142.1	46.3	525.1	6,364.6
1955..........	455.5	97.3	541.2	599.2	193.1	72.9	-	141.5	56.2	689.9	8,126.9
1956..........	490.3	105.0	608.1	683.5	231.0	107.1	91.7	145.0	62.1	582.6	6,849.4
1957..........	468.4	105.2	639.2	720.5	222.6	161.1	83.7	167.5	63.3	595.7	6,840.4
1958..........	447.6	104.2	697.4	864.0	237.5	171.1	71.1	161.0	64.3	758.7	5,381.2
1959..........	502.1	116.9	664.4	1,011.9	284.7	238.1	97.7	184.1	75.1	871.1	6,983.4
1960..........	524.5	147.6	761.7	1,073.4	427.8	408.2	122.9	174.8	97.1	1,074.4	7.520.1
1961..........	515.2	155.0	838.0	1,213.1	553.8	742.9	148.8	196.7	117.3	1,008.0	6,773.4
1962..........	582.5	166.6	1,044.9	1,338.9	704.5	933.0	174.6	212.0	136.9	1,020.3	8,007.6
1963..........	632.6	196.7	1,191.0	1,398.2	1,038.4	1,210.5	212.6	247.1	139.2	1,272.2	8,800.8
1964..........	711.7	224.4	1,211.6	1,473.3	894.0	1,494.2	261.2	275.4	145.6	1,481.4	9,426.9
1965..........	802.5	275.0	1,202.8	1,648.7	939.6	1,674.9	336.9	294.7	149.1	1,424.3	10,842.8
1966..........	812.1	255.9	1,367.8	1,633.3	1,074.7	2,060.1	249.4	226.6	156.0	1,357.1	10,618.9
1967..........	798.8	260.3	1,382.7	1,467.5	1,240.7	2,714.8	297.0	194.1	162.6	1,405.8	9,875.8
1968..........	879.8	292.0	1,406.7	1,547.6	1,253.9	3,308.2	374.6	229.9	167.7	1,389.1	11,179.5
1969..........	909.3	334.6	1,589.0	1,986.4	1,309.0	3,835.4	390.5	243.9	195.2	1,265.6	11,335.3
1970..........	765.6	321.8	1,504.3	2,271.7	1,448.2	4,100.4	479.1	222.8	225.0	1,377.0	10,178.3
1971..........	883.9	286.1	1,695.6	2,314.4	1,513.6	4,020.8	445.8	317.1	251.1	1,585.0	11,710.4
1972..........	993.5	359.3	1,886.7	2,292.0	1,552.5	4,366.6	472.5	236.5	279.0	1,985.8	12,244.8
1973..........	1,170.2	363.6	2,016.0	2,169.0	1,533.0	4,915.4	472.8	242.4	256.3	1,994.0	14,380.1
1974..........	1,188.7	369.4	1,777.8	1,800.7	1,381.9	3,849.7	444.1	277.5	217.0	1,521.1	11,358.0
1975..........	1,104.9	382.4	1,688.7	2,215.1	1,124.2	4,308.9	486.9	302.0	198.3	1,443.5	10,659.0
1976..........	1,203.9	444.8	2,151.4	2,449.4	1,282.6	4,104.1	508.5	331.9	212.3	1,533.0	12,809.5
1977..........	1,286.6	453.2	2,205.4	2,699.2	1,329.3	4,194.2	551.9	261.2	245.0	1,597.7	14,335.6
1978..........	1,307.7	448.4	2,244.5	2,819.9	1,287.5	4,681.9	631.5	217.6	285.9	1,898.4	14,909.4
1979..........	1,380.1	459.4	2,291.5	2,793.7	1,509.9	5,153.7	617.4	232.2	297.2	2,055.3	13,828.9
1980..........	1,284.8	433.7	2,196.4	2,601.7	1,652.8	5,015.5	449.1	212.3	302.9	1,816.3	11,237.7
1981..........	1,173.1	380.4	2,169.4	2,478.9	1,548.5	5,127.0	431.6	207.3	329.2	1,702.5	10,629.4

COMPILED FROM VARIOUS SOURCES

Source: Motor Vehicle Manufacturers Association of the United States - World Motor Vehicle Data (1982 edition)

Production by Japanese Companies

Source: Japan Auto Manufacturers Association, Motor Vehicle States of 1982

Production by Make

	Daihatsu				Fuji			Hino				Honda			Isuzu				Mitsubishi				Nissan Diesel		
	Cars	Trucks	Buses	Total	Cars	Trucks	Total	Cars	Trucks	Buses	Total	Cars	Trucks	Total	Cars	Trucks	Buses	Total	Cars	Trucks	Buses	Total	Trucks	Buses	Total
1956........								2,820	1,707	1,513	6,040				2,042	6,966	2,380	11,388		2,436	973	3,409	327	458	785
1957........								2,573	2,492	2,018	7,083				2,794	10,216	3,088	16,098		4,484	1,559	6,043	739	491	1,230
1958........		287		287	604		604	4,028	1,884	1,965	7,877				2,963	11,323	2,857	17,143		6,652	1,436	8,088	328	464	792
1959........		2,031		2,031	5,111		5,111	6,018	2,561	1,651	10,230				3,914	14,770	2,537	21,221		6,607	1,247	7,854	817	462	1,279
1960........		3,154		3,154	13,037	110	13,147	7,409	5,795	2,354	15,558				7,933	27,358	2,794	38,085	5,283	18,109	1,591	24,983	1,503	457	1,960
1961........		33,071		33,071	22,319	11,906	34,225	12,469	12,327	2,531	27,327				10,875	46,583	4,075	61,533	7,552	34,256	2,712	44,520	2,515	533	3,048
1962........		68,540		68,540	12,442	24,471	36,913	11,730	18,567	2,950	33,247				15,367	47,280	4,000	66,647	8,396	60,732	2,835	71,963	2,612	608	3,220
1963........	516	100,257	9	100,782	19,030	41,347	60,377	16,713	18,578	3,165	38,456	136	1,339	1,475	22,495	52,318	4,644	79,457	15,882	77,417	3,192	96,491	3,161	770	3,931
1964........	3,540	121,113	27	124,680	26,116	48,577	74,693	21,915	23,193	3,483	48,591	5,220	17,414	22,634	34,436	68,328	4,487	107,251	29,497	102,238	3,803	135,538	5,432	717	6,149
1965........	11,333	136,597	225	148,155	37,304	54,139	91,443	26,239	21,738	2,968	50,945	8,779	43,748	52,527	30,525	62,660	4,850	98,035	45,905	115,942	3,174	165,021	4,117	853	4,970
1966........	21,730	151,660	447	173,837	59,410	82,669	142,079	20,273	24,494	3,145	47,912	3,329	54,389	57,718	32,599	70,317	5,193	108,109	75,643	139,292	3,229	218,164	6,062	889	6,951
1967........	60,473	164,528	489	225,490	94,398	78,682	173,080	4,892	24,451	3,395	32,738	87,101	62,128	149,229	38,716	87,809	6,195	132,720	105,950	207,169	4,259	317,378	9,964	1,088	11,052
1968........	86,296	173,532	527	260,355	103,746	76,001	179,747	801	29,917	3,563	34,281	186,560	132,257	318,817	39,776	101,193	6,671	147,640	130,353	225,306	4,317	359,976	13,404	1,243	14,647
1969........	104,843	158,537	895	264,275	124,577	62,713	187,290	35	35,887	3,448	39,370	232,704	132,183	364,887	36,429	112,223	6,551	155,203	127,812	304,380	5,066	437,258	16,848	1,342	18,190
1970........	141,636	167,460	566	309,662	158,259	75,288	233,547	—	52,199	4,345	56,544	276,884	116,024	392,908	18,815	119,536	7,405	145,756	246,422	205,218	5,520	457,160	21,141	1,311	22,452
1971........	157,251	153,915	102	311,268	115,456	68,931	184,387	—	44,779	4,098	48,877	235,258	93,322	328,580	14,769	114,067	6,873	135,709	260,981	217,945	5,300	484,226	20,903	1,171	22,074
1972........	110,430	160,719	134	271,283	130,339	53,471	183,810	—	54,985	3,923	58,908	225,248	95,321	320,569	13,274	164,761	4,914	182,949	222,890	216,439	5,003	444,332	19,842	720	20,562
1973........	113,764	193,048	39	306,851	138,730	77,718	216,448	—	73,143	4,301	77,444	256,162	98,854	355,016	14,736	196,803	6,214	217,753	280,998	275,710	6,124	562,832	22,970	889	23,859
1974........	77,749	166,924	26	244,699	102,309	62,340	164,649	—	68,574	5,542	74,116	316,012	112,797	428,809	20,140	212,475	7,598	240,213	233,121	255,425	6,972	495,518	27,818	1,019	28,837
1975........	92,123	165,547	4	257,674	108,663	67,162	175,825	—	56,464	4,947	61,411	328,107	85,646	413,753	64,735	174,341	5,745	244,821	288,046	225,762	6,453	520,238	26,336	951	27,287
1976........	70,964	189,707	118	260,789	158,179	83,286	241,465	—	54,487	4,172	58,659	473,507	86,478	559,985	91,157	237,535	7,047	335,739	402,844	238,494	6,285	647,623	25,810	1,133	26,943
1977........	82,621	235,956	314	318,891	155,705	130,940	286,645	—	52,542	5,217	57,759	576,631	88,300	664,931	74,971	256,043	9,618	340,632	486,432	283,248	6,732	776,412	29,022	1,546	30,568
1978........	123,333	203,354	1,063	327,750	140,279	165,220	305,499	—	57,565	4,843	62,408	652,930	89,752	742,682	102,883	298,886	6,417	408,186	638,686	326,430	7,502	972,618	28,426	1,324	29,750
1979........	133,556	232,171	618	366,345	153,641	180,649	334,290	—	71,235	5,273	76,508	706,375	95,494	801,869	86,397	331,206	7,105	424,708	528,555	402,110	7,852	938,517	40,908	1,525	42,433
1980........	155,606	274,931	1,787	432,324	202,028	223,505	425,533	—	69,003	5,087	74,090	845,514	111,388	956,902	107,057	356,342	8,728	472,127	659,622	438,063	7,245	1,104,930	45,788	2,333	48,121
1981........	147,219	323,625	1,410	472,254	190,451	282,188	472,639	—	63,058	6,218	69,276	852,177	156,750	1,008,927	129,564	320,471	7,207	457,242	606,803	479,510	8,400	1,094,713	38,032	3,009	41,041

	Nissan				Suzuki			Toyo Kogyo				Toyota				Aichi	Prince				Others			Grand
	Cars	Trucks	Buses	Total	Cars	Trucks	Total	Cars	Trucks	Buses	Total	Cars	Trucks	Buses	Total	Trucks	Cars	Trucks	Buses	Total	Cars	Trucks	Total	Total
1956........	12,965	20,006	541	33,512	34	101	135					12,001	34,229	187	46,417		1,295	6,276		7,571	109	910	1,019	111,066
1957........	18,706	31,646	588	50,940	19	385	404					19,885	59,270	372	79,527		2,007	8,582		10,589	57	1,216	1,273	181,977
1958........	16,880	37,412	556	54,848	—	454	454		3,716		3,716	21,224	57,330	302	78,856		4,957	8,808		13,765	9	1,872	1,881	188,303
1959........	26,843	50,506	483	77,832	—	1,115	1,115		12,025		12,025	30,225	70,608	351	101,184	120	6,566	13,065		19,631	1	2,390	2,391	262,814
1960........	55,049	59,697	719	115,465	—	6,075	6,075	23,417	19,725		43,142	42,118	112,130	522	154,770	19,753	10,928	19,768		30,696	—	14,843	14,843	481,551
1961........	76,667	88,370	700	165,737	—	13,970	13,970	31,758	79,906		111,664	73,830	136,677	430	210,937	37,323	14,838	24,068		38,906	—	11,210	11,210	813,879
1962........	89,083	122,705	470	212,258	2,565	31,353	33,918	41,822	120,539		162,361	74,515	155,572	263	230,350	37,937	12,944	28,648		41,592	—	1,743	1,743	990,706
1963........	118,558	149,063	694	268,315	2,360	37,927	40,287	53,980	138,531		192,511	128,843	189,186	466	318,495	27,768	29,280	24,476		53,756	—	1,273	1,273	1,283,531
1964........	168,674	178,821	742	348,237	1,819	39,085	40,904	60,217	184,813		245,030	181,738	243,734	292	425,764	37,367	44,490	40,614		85,104	—	643	643	1,702,475
1965........	167,815	172,262	3,028	343,105	1,828	40,177	42,005	81,399	192,726	301	274,426	236,151	239,407	2,085	477,643	33,622	47,018	42,834	1,724	91,576	—	63	63	1,875,614
1966........	231,520	236,792	3,286	471,598	3,374	65,101	68,475	92,143	206,468	565	299,176	316,189	268,165	3,185	587,539	30,006	21,538	23,333	934	45,805	—	30	30	2,286,399
1967........	352,945	365,028	5,994	723,967	26,454	89,114	115,568	129,051	250,449	823	380,323	476,807	350,203	5,120	832,130	42,560	—	—	—	—	—	3	3	3,146,486
1968........	571,614	420,543	7,677	999,834	96,471	96,906	193,377	178,115	282,063	931	461,109	659,189	424,747	13,469	1,097,405	38,567	—	—	—	—	—	71	71	4,085,826
1969........	697,691	442,261	8,763	1,148,715	121,871	116,243	238,114	201,132	226,247	847	428,226	964,088	492,196	14,927	1,471,211	22,041	—	—	—	—	—	52	52	4,674,932
1970........	899,008	464,945	10,069	1,374,022	144,843	127,459	272,302	224,520	204,578	749	429,847	1,068,321	524,276	16,593	1,609,190	5,672	—	—	—	—	—	95	95	5,289,157
1971........	1,101,506	483,508	6,476	1,591,490	150,963	116,458	267,421	300,980	199,756	344	501,080	1,400,186	544,616	10,231	1,955,033	—	—	—	—	—	—	120	120	5,810,774
1972........	1,352,251	503,596	8,397	1,864,244	90,493	119,717	210,210	379,703	260,139	422	640,264	1,487,661	589,176	10,296	2,087,133	—	—	—	—	—	—	174	174	6,294,438
1973........	1,487,360	542,727	9,254	2,039,341	88,328	155,406	243,734	465,734	272,805	633	739,172	1,631,940	662,321	13,837	2,308,098	—	—	—	—	—	—	209	209	7,082,757
1974........	1,255,669	546,216	5,151	1,807,036	55,277	148,563	203,840	370,928	359,175	965	731,068	1,484,727	615,707	14,546	2,114,980	—	—	—	—	—	—	375	375	6,551,840
1975........	1,532,731	538,580	6,136	2,077,447	50,668	133,547	184,215	387,145	254,919	550	642,614	1,714,836	609,895	12,322	2,336,053	—	—	—	—	—	—	253	253	6,941,591
1976........	1,610,319	686,218	7,166	2,303,703	43,347	158,234	201,581	446,618	269,422	632	716,672	1,730,757	741,499	15,595	2,487,851	—	—	—	—	—	—	346	346	7,841,447
1977........	1,615,866	654,723	7,462	2,278,051	55,088	184,101	239,189	498,691	300,584	728	800,003	1,884,260	819,699	16,799	2,720,758	—	—	—	—	—	—	183	183	8,514,522
1978........	1,733,132	648,079	11,387	2,392,598	62,459	185,270	247,729	493,111	355,004	2,040	850,155	2,039,115	868,549	21,493	2,929,157	—	—	—	—	—	—	431	431	9,269,153
1979........	1,738,966	587,441	11,424	2,337,831	69,798	275,137	344,935	647,001	322,482	1,938	971,421	2,111,302	858,914	26,009	2,996,225	—	—	—		—		394	394	9,635,546
1980........	1,940,615	670,646	34,791	2,646,052	87,830	380,853	468,683	726,344	379,517	4,955	1,110,816	2,303,284	954,200	35,860	3,293,344	—	—	—	—	—	—	812	812	11,042,884
1981........	1,864,251	628,998	31,039	2,524,288	94,735	484,091	578,826	840,630	331,434	4,554	1,176,618	2,248,171	930,179	42,068	3,220,418	—	—	—	—	—	—	620	620	11,179,962

Source: Japan Automobile Manufacturers Association, Inc.

WORLD - PRODUCTION 1974-1981

30 Principal Motor Vehicle Manufacturers Ranked According to 1981 Production

		1974	1975	1976	1977	1978	1979	1980	1981
1.	General Motors (U.S.A.)......	4,672,684	4,649,530	6,233,972	6,700,294	6,875,555	6,444,652	4,753,296	4,627,645
2.	Toyota (Japan)...............	2,114,980	2,336,053	2,487,851	2,720,758	2,929,157	2,996,225	3,293,344	3,220,418
3.	Gr. Nissan (Nissan-Fuji).....	2,002,322	2,280,559	2,572,111	2,595,264	2,727,848	2,704,544	3,117,806	3,100,968
4.	Volkswagen-Audi..............	2,083,485	1,940,017	2,159,779	2,219,544	2,376,110	2,530,565	2,529,218	2,210,666
5.	Ford Motor (U.S.A.)..........	3,097,981	2,500,238	2,942,051	3,744,691	3,790,440	3,075,131	1,888,455	1,937,297
6.	Renault-R.V.I. (a)...........	1,527,089	1,427,282	1,724,448	1,793,221	1,767,346	1,945,289	2,132,540	1,810,365
7.	Peugeot-Talbot-Citroën (a)...	730,769	659,277	1,513,530	1,612,813	1,691,819	1,714,166	1,408,927	1,593,943
8.	Ford Europe (U.K.,G.B. & S)..	988,037	1,099,095	1,355,154	1,647,367	1,554,479	1,663,839	1,395,096	1,435,495
9.	Fiat-Autobianchi-Lancia-OM...	1,498,208	1,231,709	1,425,186	1,453,136	1,510,946	1,542,163	1,554,284	1,209,819
10.	Toyo-Kogyo (Mazda)...........	740,088	642,614	716,672	800,003	850,155	971,421	1,121,016	1,176,608
11.	Mitsubishi...................	495,518	520,238	647,623	776,412	972,818	938,517	1,104,930	1,094,793
12.	Honda........................	428,809	413,753	560,075	664,931	742,682	801,869	956,902	1,008,927
13.	Chrysler Co. (U.S.A.- Canada)	1,789,476	1,508,576	2,104,855	2,037,951	1,869,848	1,429,082	882,639	1,002,464
14.	Opel (General Motors)........	640,351	675,299	938,040	946,340	995,935	1,013,629	833,905	855,329
15.	Lada (Fiat-U.S.S.R.).........	650,000	690,000	710,000	725,000	740,000	830,000	825,000	830,000
16.	General Motors (Canada)......	646,151	598,876	713,714	776,993	855,999	845,029	763,663	757,406
17.	Talbot (F. G-B.S.)...........	780,779	719,619	756,641	754,060	898,713	711,635	642,575	-
18.	Daimler-Benz.................	512,393	556,470	626,078	661,982	647,562	692,962	717,218	712,315
19.	Suzuki.......................	203,860	184,215	201,581	239,989	247,729	344,935	468,683	578,876
20.	Isuzu........................	248,213	244,821	335,739	340,632	408,186	424,788	472,127	457,242
21.	British Leyland..............	863,161	738,240	808,409	770,973	743,103	503,767	395,820	427,495
22.	Ford Canada..................	598,621	481,362	527,237	589,295	629,485	491,413	434,902	357,527
23.	B.M.W........................	188,965	221,298	275,022	290,219	320,853	336,981	341,031	351,545
24.	Volvo (S.W.-N.L.)............	257,480	331,337	335,587	245,037	275,816	336,437	285,750	302,172
25.	Polski Fiat..................	104,000	135,000	183,000	200,000	292,000	305,000	330,000	286,000
26.	Moskvitch....................	280,000	300,000	315,000	320,000	320,000	325,000	230,000	235,000
27.	Seat (Licence Fiat)..........	364,695	332,078	347,057	352,943	288,103	298,859	297,632	206,628
28.	American Motors..............	487,005	463,702	366,178	312,954	359,131	343,194	252,286	201,567
29.	Alfa Romeo...................	210,995	191,810	203,176	203,175	222,599	209,550	221,243	198,857
30.	Saporoskje (U.S.S.R.)........	120,000	130,000	145,000	145,000	140,000	145,000	150,000	155,000

NOTE: (a) Group Renault-RVI (Saviem-Berliet) and Group Peugeot-Citroën from 1975 to 1980 and Peugeot-Talbot-Citroën in 1981.
(b) Since 1975 total Volvo production in Sweden and in The Netherlands.

L'ARGUS

Source: Motor Vehicle Manufacturers Association of the U.S. - World Motor Vehicle Data (1982 edition)

For FC production, highly refined materials are used, and FC have a chemical composition adjusted with a high degree of precision. FC are ceramics which are synthesized through a well-controlled moulding and sintering process and which display the required performance in a high degree because they have a carefully designed structure and superior dimensional precision.

Fine Powder of Under 1 Micron in Grain

The purity which the raw materials for FC production are required to have is so high that it is unimaginable from the raw materials of conventional ceramics. It is 99.99 per cent or above. In other words, impurities of up to 0.01 per cent only are allowed.

The grain size of the powder and the manufacturing process wholly differ from those for ordinary ceramics. In some FC, powder of less than one micron (one-thousandth of a millimeter) in grain size is used. This is the same as the wavelength of visible rays.

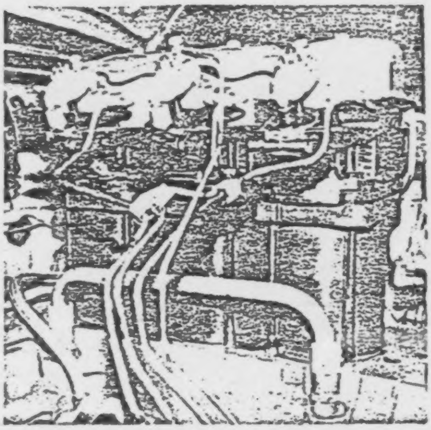
Man-made materials are used for FC production but a process where there is a danger of admitting impurities, such as mechanical pulverization of a solid material, is not used. Ultra-fine grains of a high purity obtained by a solidus phase reaction, a liquid phase reaction and a gaseous phase reaction are used.

A solidus phase reaction is a process in which two or more kinds of solid materials react with each other and produce a new solid material. A liquid phase reaction and a gaseous phase reaction are processes in which ultra-fine grains are produced from a liquid phase or gaseous phase reaction or reactions. Grains of less than one micron in diameter are obtained. Moreover, grain size distribution can be controlled. Depending on the way to cause a liquid phase reaction, one can obtain active ultra-fine grain powder whose grain diameter is 1/50 to 1/100 micron, powder which is just like oil smoke.

GEE Products of the United States, producer of silicon nitrate powder used in FC engines, practices the chemical vapor deposiition (CVD) process based on a gaseous phase reaction and produces powder of grain diameter less than one micron and purity of 99.99 per cent. The product is imported to Japan. Japanese manufacturers are making preparations to practice this process.

Thus, the FC technology is not on the extension of the conventional ceramic technology but belongs to a different, higher order. Then, what is the situation in Japan related to the FC technology and production, the basis for FC engines?

In a word, the potential is not low but Japanese manufacturers have not yet attained a stature where they can compete with their U.S. counterparts. Production of FC material powder in Japan has not yet reached a size where various processes are practiced in industrial scale and the economy of scale is obtained.



Ceramic engine developed by Kyoto Ceramic: The company succeeded in a test run of an FC engine-mounted vehicle.

Withstanding High Temperature

How does Kyoto Ceramic appraise the FC engine and how does it plan to bring it to use for practical purposes? Says Kazuo Inamori, president of Kyoto Ceramic: "Japan has the most advanced technology and the best records in the world in production of electronic ceramics. FC's great characteristic is that it has a great strength at a temperature which metals cannot withstand and that it can be used as the material of parts which are exposed to severe thermal and mechanical conditions, such as parts of motor vehicle engines.

"Metals are oxidated in a high temperature. Even a heat-resisting alloy which excels most in high-temperature strength begins to weaken and becomes soft and prone to deform when the temperature reaches about 600 degrees centigrade. At a temperature of 1,000 degrees or over, it can scarcely support a load.

"Ceramics, however, are difficult to oxidate and do not soften at all at a temperature of 1,500 degrees centigrade where many metals melt. If an engine of ceramics which need no cooling is built, the thermal efficiency (of an internal combustion engine) will dramatically increase. (The heat lost in cooling is 30 per cent.)

Ceramic Engine: Technological Frontier

—Ceramics Open a New World—

By Yasunobu Otori

A revolutionary engine has made its debut in the world of motor vehicle engines which was long in stalemate. It is a ceramic engine.

Toward the end of 1981, an automobile equipped with the world's first ceramic diesel engine was driven in a test run at Kyoto Ceramic Co.'s Ceramic Center Research Laboratory in Kokubu City, Kagoshima Prefecture and attracted the attention of the world.

The ceramic of which the engine of this vehicle is made differs from the ordinary ceramic. It is fine ceramic which is widely known for its outstanding heat resistivity, wear resistivity and mechanical strength. Both the cylinders and the pistons are made of fine ceramic. For the development of this fine ceramic and the designing of an engine made of fine ceramic, Isuzu Motors has been cooperating with Kyoto Ceramic for several years. The ceramic engine tested on that occasion is a three-cylinder, 2,000cc one, suited for practical use.

Kyoto Ceramic modestly said that the company only wanted to prove that at the present technical level, such a thing is possible. But the significance of this engine is much greater than Kyoto Ceramic says. The ceramic engine is the precursor of an engine revolution which will make the conventional, low-efficiency metal engines a museum piece.

Engine Which Needs No Cooling

The ceramic engine is still in an experimental stage, but the three cylinders wh[illegible] protrude like chimneys show that the engine is an epoch-making product. In the case of a conventioal metal engine, cylinders are invisible from outside because they are surrounded by cooling water pipes. Moreover, a conventional metal engine is equipped with a radiator. Anyway, it has many adjuncts.

The ceramic engine, on the other hand, has no such adjuncts at all because it needs no chilling. Naturally, the temperature of the gas in the cylinders is high and the engine's thermal efficiency is excellent. Thirty per cent of the heat taken away by the cooling water of an ordinary engine can be saved. The ceramic engine's efficiency improves 15-20 per cent compared with that of a metal engine if the high-temperature exhaust gas is recycled by means of a turbo-charger, etc.

Because the engine's weight is doubly reduced by the omission of the cooling system and by a reduction in the size through improvement in the efficiency, the engine's lightweightness further improves its efficiency. The engine revolution will trigger a revolution in motor vehicles. The driving force behind this revolution is progress in fine ceramics.

Precursing FC-DE Vehicles Introduced

Such words or phrases as "ceramics," "new ceramics" and "fine ceramics" are much in vogue these days. We have to define them here in order to clarify the new product which is fueling the engine revolution.

"Ceramics" are general term for pottery and porcelain, refractory materials, bricks, glass, etc. They are produced by heating powder materials to a high temperature, sintering and melting them and causing chemical reactions in them.

However, if a natural material is used in its natural form, the quality and characteristics are limited. Therefore, higher-quality new ceramics have begun to be produced by refining natural materials to a high degree or chemically synthesizing a material which does not exist in nature and using it as a material.

Silicate is used as a raw material to produce conventional ceramics. But the new ceramics are produced by using other materials than silicate, such as alumina and silicon carbide. Alumina could not be used for production of conventional ceramics but silicate can be used as an auxiliary material for production of new ceramics. By doing so, the precision of dimensions and shapes is obtained. However, the use of the auxiliary material robs the product of a considerable part of alumina's characteristics. In the new ceramics stage, the material's original properties are not fully displayed.

Scholars define "fine ceramics" as one step beyond new ceramics. Fine ceramics (FC) are "precision ceramics" where the superior characteristics of the material, such as heat resistivity, anticorrosiveness, hardness, heat conductivity and electric insulating ability, are fully displayed.

"However, engine parts are subject to severe repetitive stresses. Accordingly if parts made of such a hard and brittle material as ceramics (including cylinders and pistons) are going to be used in mass-produced engines, unusual efforts will be required to guarantee the engines' reliability.

"Technology for (nondestructive) tests of parts of complicated shapes, such as pistons and rotors, is yet to be established. Therefore, a testing technology which can be adopted in the process control for mass-produced goods and whose precision is reliable should be developed.

"Ceramics manufacturers must increase the strength of mass-produced products and minimize the unevenness of the quality and process the goods efficiently into the required shapes with the required degree of precision. To increase the strength, a strict quality control in the manufacturing process is necessary. In addition, reinforcement by a special process is also conceivable.

"Regarding the precision of processing," Inamori goes on, "diamond tools must be used to cut and process FC because FC are very hard, but because of their hardness, FC develop little elastic deformation, so it must be possible to process FC with a better efficiency and up to a higher degree of precision than metals if suitable tools are used and suitable cutting conditions are ensured."

Kyoto Ceramic's development goals are all FC which ensure higher energy economy, greater heat resistance and a longer life, such as FC for use in cardinal parts of motor vehicle diesel engines, rotors and ball bearings of gas turbines for electric power generation, spindles of ultra-high precision machine tools, tubes of high-temperature heat exchanges and inside walls of nuclear fusion reactors.

Regarding the motor vehicle diesel engine (of 2,000cc) using an FC of silicon nitrate, Kyoto Ceramic was awarded MITI's (the Ministry of International Trade & Industry) technical development subsidy of ¥120 million a year since fiscal 1979 and has completed a trial model. In fiscal 1981, Kyoto Ceramic launched a four-year second research and development program to develop a practical model on the basis of three years of research and development effort.

Concurrently, Kyoto Ceramic is engaged in joint endeavors with Isuzu Motors for the improvement of the engine design, the development of a production technology and reduction of the production cost. It means that the company intends, in the coming four years, to improve the quality of FC further, develop an engine design which enables FC to display their superior characteristics to the utmost, reduce the number of parts greatly and make the FC engine lightweight, compact and fuel-efficient and bring down its production cost and develop an FC engine which can be used for practical purposes. Kyoto Ceramic hopes to develop a four-cylinder 2,000cc engine.

Toyota and Nissan Also in Development

Kyoto Ceramic led the others in the trial run of an FC engine vehicle but made a belated start on efforts to develop an FC engine.

Toyota Motor Co.'s Central Research Institute already in 1965 started effort to develop a ceramic engine with a conviction that ceramics were the only material of a motor vehicle engine in the future.

It has been reported that Toyota sintered a unique FC of the silicon nitrate family at a temperature of 1,750 degrees centigrade and this FC displayed a strength of 100 kilograms per square millimeter at a temperature of 1,200 degrees centigrade. Toyota produced this FC under normal atmospheric pressure and this has been appreciated as a major accomplishment for eventual mass production of FC engines.

Regarding the prospects for the development of an FC diesel engine at Toyota, it is expected that a trial model will be completed in about 1985 and a car suited for practical use will be completed by the end of the 1980s. Regarding the prospects for a gas turbine vehicle, it is expected that both the experimental car and the car for practical use will be completed not earlier than 1990.

Nissan Motor Co.'s Central Research Institute is also carrying out research for the development of FC engine parts. Nissan says that it is possible to run an experimental car equipped with an FC diesel engine by 1985 but there are many problems in the development

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of a mass-producible engine. Nissan, like Toyota, says that it will be after 1990 that an FC gas turbine is put to practical application.

Toshiba Corp., which manufactures FC, has succeeded in synthesizing a high-quality silicon nitrate powder of a grain diameter of 0.5-1.0 micron whose sintering characteristics are good. An FC made of this material displays the strength of 126 kilogram per square millimeter at the temperature of 1,200 degrees centigrade. Toshiba says that it will develop in conjunction with an automaker an FC diesel engine capable of practical application in the second half of the 1980s.

MITI Prodded into Action

A gas turbine rotor jointly developed by General Motors Corp. and Carborundum Co., both of the United States, was shown at the annual convention of the Society of Automotive Engineering (SAE) held in Detroit in February, 1981. It attracted much attention as a proof of the high U.S. technology because the gas turbine rotor rotates at a very high speed and its development is considered a very challenging task.

MITI, taking a serious view of Japan's technological lag in this area, included FC in its research and development program for next-generation technologies in fiscal 1981 and launched efforts to foster the growth of FC technology. The FC Study Council was set up at the end of 1980 among nine companies, including Kyoto Ceramic, Toshiba and the Advanced Machining Technology & Development Association. In August, 1981, 15 Japanese corporations, including Kyoto Ceramic, Toshiba, NGK Insulators, NGK Spark Plug, Denki Kagaku Kogyo, Shinagawa Refractories and Kurosaki Refractories, formed the Engineering Research Association for High Performance Ceramics under MITI's guidance. A budget of ¥13 billion for a 10-year period has been appropriated for the research by this association. The research will be mainly entrusted to the member companies. The purpose of the research is to catch up with the U.S. level through a competitive research system. It is expected that Japan will catch up with the U.S. in five or six years in regard to FC engines because the member companies have high technology. Kyoto Ceramic, for example, began to export stator blades of FC turbines to General Motors and Ford Motor Co. two years ago. *(The writer is critic on science.)*

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APPENDIX 9

WORLD - IMPORTS FROM JAPAN 1968-1981

Japanese Car Import Penetration-Selected Countries (In Percentages)

	1968	1970	1972	1975	1976	1977	1978	1979	1980	1981
Australia............	–	15.4	19.6	32.7	30.0	34.7	33.3	31.2	35.2	34.1
Austria..............	0.1	0.9	7.2	5.4	6.0	5.7	7.0	12.4	19.2	25.4
Belgium..............	3.1	4.9	10.0	16.5	18.0	19.3	17.9	18.0	24.7	24.7
Denmark..............	1.6	3.4	7.1	14.7	16.5	17.1	13.7	18.0	30.9	24.2
Finland..............	14.9	18.3	19.2	20.8	21.9	21.8	20.4	23.9	36.3	33.0
France...............	0.6	0.2	0.4	1.5	2.7	2.6	1.8	2.2	2.9	2.6
Germany West.........	0.1	0.1	0.3	1.7	1.9	2.5	3.7	5.6	10.4	10.0
Ireland..............	–	–	–	–	11.5	15.5	21.8	25.4	31.1	29.6
Italy................	–	–	–	–	0.1	0.1	0.1	0.1	0.1	0.1
New Zealand..........	–	6.3	17.8	23.8	26.5	32.8	33.5	48.4	58.4	63.4
Norway...............	3.9	11.4	15.8	28.3	28.3	25.4	20.4	24.2	39.1	37.9
Portugal.............	1.5	10.7	24.9	20.5	16.1	15.2	17.6	7.9	7.5	11.9
Sweden...............	0.1	0.7	2.8	6.5	8.2	10.4	9.7	10.0	12.1	13.7
Switzerland..........	1.5	5.6	13.7	8.4	5.8	12.1	12.6	16.0	23.2	26.9
The Netherlands......	1.2	3.1	9.5	15.5	16.8	19.8	19.0	19.6	25.7	24.4
United Kingdom.......	0.2	0.4	2.9	9.0	9.4	10.6	11.0	10.8	11.9	11.0
United States........	1.2	3.7	5.7	9.4	9.3	12.4	12.0	16.6	21.3	21.8

– Not available.

FROM VARIOUS SOURCES OVERSEAS

Source: Motor Vehicle Manufacturers Association of the U.S. - World Motor Vehicle Data (1982 edition)

WYETH INTERNATIONAL LTD.,
March 10, 1983.

Hon. SAM GIBBONS,
Chairman, Subcommittee on Trade, Ways and Means Committee, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I would like to commend you for conducting a hearing on March 10 on U.S.-Japan bilateral trade relations, and for the opportunity to submit a statement for the hearing record. Trade relations between the U.S. and Japan are among the most important in the world's free market trading system. Your efforts to maintain this relationship on a fair and equitable basis are appreciated.

Attached is a statement that I respectfully request be included in the record of the Subcommittee's hearing. It bears on one topic for the March 10 hearing, that is "the current degree of openness of the Japanese market to competitive U.S. products, including a review of progress by Japan in implementing its three previously announced trade liberalization packages."

As you see, the statement is very specific; it deals with one particular problem that Wyeth International has with access to the Japanese market: the high tariff and quota imposed on imports into Japan of electrodialyzed whey (EDW). Despite repeated attempts, on part of the U.S., a resolution to the EDW problem has not been addressed by the Japanese government in any of the previous trade liberalization packages.

Wyeth, one of the major American pharmaceutical companies has been selling its infant formulas in Japan for 19 years. It maintains a substantial investment in production facilities in Japan and provides stable employment for Japanese workers. Equally important, it also provides a market for an American export which is the main component of the Wyeth infant formula products manufactured in Japan, products which represent the advanced state of the technology in infant nutrition.

Wyeth International has sought for several years to have the tariff on American EDW reduced or eliminated. During the past two years, the Office of the U.S. Trade Representative has been helpful in raising the problem of the tariff on EDW in direct discussions with Japanese government officials. There has been no progress in addressing our concerns—the tariff on EDW—the most compelling of which is that there is no directly competitive industry in Japan for the tariff and quota to protect. Thus, Japanese practice in this instance detracts from the kind of open, mature trading relationship both countries seek.

Thank you again for providing this opportunity to present to the Subcommittee the problems of EDW importation. We remain hopeful that when the Subcommittee visits Tokyo for meetings with Japanese trade officials later this month, that it will take the occasion to raise again this concern with the Japanese. I would also be happy to provide you and your committee with any further information you should desire on the case.

Respectfully submitted,

E. STEVEN BAUER,
Vice President, Corporate and Government Affairs.

Enclosure.

STATEMENT OF CASE—WYETH INTERNATIONAL

I. EXECUTIVE SUMMARY

A. The Problem

Japan imposes a 25 percent ad valorem tariff and a quota on imports of electrodialyzed whey (EDW), a type of demineralized whey, which is a key ingredient in the Wyeth Corporation's infant formula, SMA/Formula 26. Wyeth International, an American corporation, has been selling its infant formulas in Japan for 19 years. The formula is produced by Wyeth International's wholly-owned Japanese subsidiary, Wyeth (Japan) Corporation, and sold on the Japanese market.

The EDW used by Wyeth (Japan) is exported from the U.S. There are no production sources of EDW in Japan.

B. The Goal

To eliminate the tariff and the quota imposed by Japan on imports of EDW.

C. The Justification

Wyeth considers its continued presence and the success of its new investment in Japan to be closely linked to the elimination of the tariff and quota. The following are the reasons why Wyeth feels the tariff and quota should be eliminated:

1. *There is no directly competitive industry in Japan.*—Wyeth (Japan) must import EDW since there is no EDW production in Japan. Therefore, the Japanese tariff and quota do not protect a directly competitive Japanese industry. Japan does not produce this product or a comparable product, so we see no reason for continuation of these punitive trade barriers.

As will be discussed below, skim milk is not an acceptable substitute for demineralized whey in Wyeth (Japan)'s infant formula. Elimination of the tariff and quota would not displace skim milk as an ingredient.

2. *The tariff and quota substantially increase costs.*—EDW is an essential component of Wyeth (Japan)'s infant formula product. In 1980, Wyeth (Japan) completed a new $8.5 million infant formula production facility in Japan. The tariff and quota increase the manufacturing costs and the local selling price, thus potentially jeopardizing this new investment. The loss of this investment would result in a loss of employment in Japan and a loss of U.S. exports of demineralized whey.

3. *The tariff and quota restrict U.S. exports.*—Wyeth (Japan) purchases all of its EDW from the U.S., and the present tariff and quota serve as impediments to U.S. exports.

4. *The Wyeth infant formula is a U.S. presence in Japan's market.*—The Wyeth infant formula marketed in Japan is an easily identifiable American-developed product introduced into and now manufactured in Japan, and recognized as such. It thus plays a role in maintaining a visible American presence in the Japanese marketplace.

5. *The quota creates planning uncertainties.*—The quota has been administered based on prior usage and existing inventories, with no fixed levels used by Japan's Ministry of Agriculture. The quota introduces uncertainty into Wyeth (Japan)'s manufacturing and marketing planning, since the quota has no set numerical limit but instead changes from semester to semester, based on the Ministry's estimates of the above noted factors.

II. BACKGROUND ON USE OF ELECTRODIALYZED WHEY (EDW) IN JAPAN

Wyeth International (U.S.A.) exports about 1,200 metric tons per year of electrodialyzed whey (EDW), at about $1,140.00 per metric ton, totalling about $1,400,000 per year in U.S. exports of demineralized whey. EDW is an essential ingredient in the infant formula produced and sold by Wyeth (Japan) Corporation in Japan, since it permits the infant formula to match the protein ratio of mother's milk as closely as technically possible today, while at the same time removing excessive levels of sodium and potassium from the whey. This results ultimately in an extremely high quality infant formula product. There is no patent on the infant formula produced by Wyeth (Japan) Corporation.

The EDW imported by Wyeth (Japan) Corporation is obtained exclusively from Wyeth International (U.S.A.), a research-based pharmaceutical company which is not engaged in the dairy industry. Wyeth International (U.S.A.) obtains its supplies of EDW from Foremost Foods, a U.S. dairy enterprise, which manufactures EDW to Wyeth's particular specifications. Wyeth administers quality control of the EDW before shipping supplies to the Wyeth subsidiary in Japan and elsewhere.

Japan imports a total of approximately 11,700 tons of wheys classified under Tariff Schedule 04–02.3 per year. In addition to Wyeth (Japan) Corporation, four major Japanese food producers use demineralized wheys to produce infant formulas and other food products, some of which are exported. These four Japanese companies which manufacture some infant formulas containing whey are: Snow, Morinaga, Meiji, and Wakodo.

One large food company user of demineralized whey in Japan, Morinaga, has recently entered into a joint venture in Norway for the production of demineralized whey, using as a necessary base the large Norwegian cheese industry.

There is no domestic production of demineralized whey on a commercial scale in Japan. Demineralized whey is made from a byproduct of large-scale production of cheese. The manufacture of SMA/Formula 26 can use only the EDW from specific cheese types yielding a so-called "sweet whey" (such cheese types include cheddar, Gouda, Edam). Japan, which is not a large cheese-consuming country, lacks such large-scale cheese production.

Infant formula manufacturers in Japan who do not use special wheys employ skim milk. This does not provide the nearly perfect match of protein ratio with human milk which is supplied by demineralized whey. Wyeth's formula is viewed by medical experts as representing the most advanced state of the art.

Wyeth (Japan) now has about 7 to 8 percent of the Japanese domestic infant formula market. Wyeth has been able to increase its market share this past year during a general contraction of the market.

III. THE TARIFF

A. Existing Tariff

The Japan Tariff Schedule Number for non-sugared whey powder is 04.02-3. (The TSUSA number is 118.05). Demineralized whey is classified under these tariff schedule numbers.

Japan has a 25 percent ad valorem tariff on nonsugared whey powder, cost and freight, Japanese port of entry. This tariff is not bound under the General Agreement on Tariffs and Trade. (The four Japanese companies importing demineralized whey to produce infant formula for export presumably receive a rebate on the demineralized whey tariff for that portion used in the final exported infant formula product.)

B. Prior Efforts to Decrease the Tariff

Wyeth International (U.S.A.) requested in 1978 that the U.S. Government negotiate reduction or elimination of the tariff on demineralized whey during the Multilateral Trade Negotiations (MTN). Discussions were held with the Office of the Special Trade Representative and the Commerce Department's Office of Country Affairs (Japan), in the Bureau of International Economic Policy and Research. Wyeth International did not have a representative on an agricultural sector advisory group, although it did participate on ISAC 6 for its pharmaceutical products. Mr. Steven Bauer, Vice President, Corporate and Government Affairs, was the Wyeth International executive undertaking these discussions with Commerce and STR.

The U.S. Government placed the item on the negotiating agenda, but the Japanese Government made no response and the tariff was not changed in the MTN.

Wyeth seeks removal of the tariff because it significantly increases the price of the final product marketed in Japan, which is already some 35 to 45 percent higher than its competitors' products.

IV. QUOTA

The Ministry of Agriculture in Japan requires that a quota license be obtained for demineralized whey imports on a six-month basis, as is required for all non-liberalized items. The Ministry has usually granted Wyeth (Japan) Corporation's quota request in full, although the last two requests were each cut by about 7 percent from the previous level. This was for the periods of April 1980–September 1980 and October 1980–March 1981.

It is the view of Wyeth (Japan) that the Ministry of Agriculture considers several factors when deciding on the six-month quota level, including (1) Wyeth (Japan)'s prior usage and inventory level (2) the level of whole milk production in Japan, (3) the general balance of payments situation, (4) the influence of the dairy farmers in Japan, and (5) the general political situation.

Wyeth International would like to see elimination of the quota because of the restraints and uncertainties which it places on the sourcing of Wyeth (Japan) Corporation. The quota also increases Wyeth (Japan)'s cost burden in two ways: First, because of the quota requirement, Wyeth (Japan) is forced to carry protective inventories at all times. Second, because Wyeth (Japan) is tied to a fixed six-month quota licensing system, it must follow a rigid schedule of purchases and cannot follow normal market trends.

V. JAPAN'S RATIONALE FOR PROTECTION

The infant industry or protected industry rationale for a tariff and a quota is not relevant because there is no domestic production of EDW in Japan, and Wyeth (Japan) must therefore import it. As a result, elimination of the tariff and quota will not adversely impact Japanese employment or employee wages. In fact, as noted above, if the import barriers continue to be imposed, Wyeth's new investment runs the risk of being jeopardized, which in turn will harm Japanese employment.

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